Canada

Brief to the Royal Commission on Banking and Finance

[Submissions]

VOLUME II

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M	Non-resident Investment
N	Taxation

Submitted June, 1962 by

THE INVESTMENT DEALERS' ASSOCIATION
OF CANADA

Brief to the Royal Commission on Banking and Finance

VOLUME II

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BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX A

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Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX A

THE INDUSTRY AND THE ASSOCIATION

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PART I

THE INVESTMENT BUSINESS — AN OVERVIEW

Origins and Development

1. The roots of the investment business go back to the 1880's, when the first securities houses were founded. At that time most industrial and commercial businesses were small in size, their capital needs were modest and the use of the corporate form was not widespread. There were relatively few Canadians with surplus savings who were seeking investment opportunities and most of the long-term capital came from the London market. Canadian dealers established connections with English banking houses and acted as agents in arranging the sale in London of Canadian municipal and other securities.

2. By the turn of the century investment dealer operations had grown to include arranging capital issues for corporations engaged in transportation, public utilities and manufacturing. For example, in 1899 we find a dealer inviting subscriptions for $300,000 of $100 par value 7% preferred shares of Dunlop Tire and Rubber Goods Co. Limited. This issue was well over-subscribed and allotments were made on the basis of 1 in 10.

3. In the early 1900's, as a result of continuing economic growth, more corporations sought "outside" capital and investment dealers underwrote and sold quite substantial issues. Thus in June 1911 we find a group of three dealers offering $1,500,000 of 6% First Mortgage Sinking Fund Bonds of Canadian Locomotive Company Limited. It would appear that these bonds were still in primary distribution in late October, 1911.

4. At that time costs of doing business were low and spreads were wide by today's standards and the sale of a new issue was a leisurely affair, usually spread over several weeks. There was no securities legislation nor prospectus requirements. Sales effort consisted of the preparation of a brief circular which was mailed to a relatively short list of known investors.

5. When War broke out in 1914 more than three-quarters of all new issues of bonds were still being placed in London. Within a year this source of funds had dried up and after a brief period of access to the New York market, Canada was forced to turn to domestic sources of funds to finance her War effort. In 1916, the 32 investment dealers then in business formed themselves into what is now The Investment Dealers' Association of Canada and set about organizing a Victory Loan sales campaign which reached eventually every town and village in the land.

6. The first domestic War Loan was offered in 1915, was over-subscribed and was followed by successful Loans in 1916, 1917, 1918 and 1919. In six Loans over $2.2 billion was raised from 2,845,171 subscribers -- an impressive sum for a country of Canada's size -- and marked the beginning of a new stage of development in our capital market.

7. In 1920 the Minister of Finance requested investment dealers and banks to form a Marketing Committee to stabilize the market for Victory Bonds. Heavy sales by Canadian holders of Victory Bonds and a fall in sterling exchange which triggered a return flow of Canadian securities from the United Kingdom, threatened to cause precipitous price declines. The Committee succeeded in maintaining orderly market conditions and achieving a redistribution of some $150 million of "Vics".

8. The upsurge of industrial development in the decade following the First World War was facilitated by the presence in the country of thousands of new investors who extended their purchases to include new issues of bonds and shares arising from the growth of railway and transportation systems, hydro-electric power installations and the establishment and expansion of resource development and secondary manufacturing industries. This was a period of great activity for the securities business and over 80 new investment houses were founded

between 1920 and 1929. Some idea of the increase in new issue financing during this period is given by the following table:

	1920	1925	1929
		(millions of dollars)	
Federal Provincial	126	319	139
Municipal	56	52	97
Corporate	46	126	298

9. This period saw the development of the syndicate system for underwriting and distributing new issues. As the size of individual underwritings grew, it became prudent for the investment dealer purchasing the securities--sometimes known as "the house of issue"--to organize a syndicate of dealers who would share the liability by agreeing to underwrite part of the issue, usually at a small increase or "step-up" from the original purchase price. Today this syndicate is called the "banking group". To be a banking group member a dealer must have the financial strength to undertake the liability. Larger issues require a greater selling effort and, in due course, we find the banking group inviting other dealers to join a "selling group", again at a step-up from the banking group price. The selling group dealers are each offered a participation or may be invited to place an order with the manager of the banking group. The selling group dealer's liability is limited to the actual amount of securities allotted to him. Most new issues have been and are underwritten in Montreal and Toronto but selling group members are selected from various parts of the country in order to secure the widest distribution possible.

10. The house of origin began to accept increasing responsibility for co-ordinating the sale of the new issue and for the maintenance of orderly marketing conditions while the issue was being distributed. These arrangements were not the invention of any one firm but evolved out of the conditions under which the dealers operated.

11. Subsequent to 1929 the investment business passed through a period of trial and tribulation. As the great depression settled upon the world, earnings and tax collections dwindled and security prices declined disastrously. Many municipal and corporation issues defaulted on interest payments and fear spread among investors. Investment dealers suffered heavy losses and many substantial firms hovered on the edge of insolvency. The sharp decline in securities prices which followed when Britain went off the gold standard in 1931 impressed upon the dealer community the importance of speeding distribution of new issues to reduce the time during which a new issue liability was carried. As the crisis passed, underwriting houses and investing institutions worked away at problems involving corporate reorganizations and plans for debt readjustment of municipal and provincial issuers. Many municipalities sought and obtained from investment houses which specialized in municipal debentures, advice and assistance with debt and financing problems. The decline in volume of new issues in the early 1930's led to greater emphasis upon activity in the secondary or between-dealer market.

12. Increasingly vigorous competition for what little business was available resulted in the dealer becoming more competent in appraising the strong and weak points of securities and more skilful in putting together proposals for the exchange of securities owned for other securities which offer the investor some advantage of price, term, yield or other feature. A substantial volume of business developed in the movement of Canadian securities between Canada and foreign countries as exchange rates and interest rates changed. Taxes began their climb and taxation considerations offered dealers a new area where they could serve their clients and develop new business.

13. Paralleling this growth in dealer "know-how" came increasing discrimination on the part of investors -- especially institutional

investors who were coping with securities which had failed to perform as anticipated. This climate of difficult markets, more selective buyers, lower volume of business and strenuous competition between investment dealers was in marked contrast to the buoyant, relatively unsophisticated 1920's when the dealer was principally concerned with underwriting and distributing new issues and, in view of the unbroken debt record of borrowers, had no reason based on experience to build into security issues an "extra" margin of safety against depressed economic conditions.

14. In retrospect, it can be seen that the 1930's provided investment dealers, issuers and investors with unforgettable lessons in the hard school of experience -- lessons which were later reflected in improved municipal financing standards and generally better-designed municipal and corporate new issues.

15. During the years 1940-45 activity in the securities business centred in the work of the National War Finance Committee. Once again the Federal Government called on dealer personnel to serve on national and regional committees to spearhead the sales organizations which blanketed the country. The magnitude of this effort is indicated by the results: in two War Loans and nine Victory Loans over 23 million subscriptions were secured totalling some $13.1 billions.

16. The investment industry began the post-war period with the conviction, based on the number of Canadians who had purchased Victory Bonds, that it was feasible to build a much larger securities business. During 1945-46 industry leaders, through the agency of The Investment Dealers' Association of Canada, initiated a long-range programme of action designed to raise minimum capital requirements of Member firms, ensure the maintenance of the highest ethical standards, develop employee training facilities and provide investment courses for the general public. The results of this major effort on which was expended thousands of man-hours, are given in part 2 of Appendix A.

17. The growth of the investment business in the post-war period exceeded all expectations. One example: in 1915 three dealers underwrote and sold over a period of some weeks $1 million of Province of Ontario, 10-year 5's which were free of all provincial taxes, including succession duties. In 1955 a group of some 30 dealers and banks underwrote and distributed widely in one day $100 million of Ontario Hydro 22-year 5's at par despite the prevailing high level of taxation on income.

The following table gives some idea of the volume of public new issues of bonds since 1946:

	New Issues (millions of dollars)			
	1946	1951	1956	1961
Federal	4,863	4,059	7,777	9,372
Provincial	115	379	557	998
Municipal	129	218	318	443
Corporate	584	453	860	568

The increase in volume, however, has been accompanied by some new patterns due, among other factors, to the following influences:

18. At the end of the War investors and financial intermediaries were large holders of Government of Canada Bonds. When it became apparent that expansion rather than recession lay ahead, selling of Canada obligations began as the need for liquidity increased and the investment business entered upon a period -- still with us today -- of complex problems surrounding the buying and marketing of Canada Bonds. These problems involve, in addition to the management of the national debt by the authorities, the use of the bond market in the implementation of monetary policies, the use of Federal deficit financing when slack exists in the economy and a decreasing investor appetite for long-term Government of Canada obligations. Demand-supply factors are no longer the chief consideration of the dealer in Canada obligations.

19. From 1950 to 1960 an up-swing took place in investor demand for equities. This demand, which was accentuated by the 20% tax credit,

stemmed from two conflicting motivations-- a desire to share in Canada's economic growth and also to acquire a hedge against further decline in the purchasing power of our dollar. An increasing proportion of the dealer's earnings derived from stock business. New issues of corporate bonds and debentures were made more saleable by attaching to them a call on common stock in the form of a conversion privilege or a warrant. This trend has been accompanied by a growing investor preference for fixed income securities which offer protection against market fluctuations, e.g., Canada Savings Bonds and the Parity Bonds issued by certain provinces.

20. By 1945 Bank of Canada had become the dominant factor in the high grade bond market, both from the standpoint of holdings of Canada bonds and of trading activity. This made it imperative that the dealers should understand central bank policy. Sometimes this was difficult.

21. Since the introduction of the money market in June, 1954, investment dealers have generated a large volume of trading in short term securities and have shown corporation treasurers, municipal officials and other holders of short-term balances how to use these funds more effectively. Today a varying, but substantial, proportion of the industry's inventory is financed outside the banking system.

22. Increased financial capacity and the employment of more specially trained staff have enabled dealer organizations to underwrite and distribute much larger issues than in the pre-war period in spite of keener competition which has narrowed profit margins both in the primary and secondary markets. Costs of doing business rose steadily during the 1950's and it has become more difficult to carry on a retail business at a profit.

23. Public demand for social security has resulted in an increased flow of contractual savings to investing institutions

(including life insurance companies, pension funds, bond and stock pooled funds, investment companies and so on) and a number of dealers are specializing in transactions with such institutions.

24. Investment dealer facilities, including branch offices in the United States, United Kingdom and Europe, for the sale and purchase abroad of Canadian securities increased during the 1950's and were a significant factor in stimulating foreign interest in Canada.

25. The history of the investment business to date, covering periods of war and peace, prosperity and recession, demonstrates its capacity to adapt itself to varying conditions, including changing investor preferences and fluctuating demands for capital.

THE INVESTMENT BUSINESS TODAY

26. Although influenced by practices and institutions in the older London and New York markets, the investment business in Canada is the result of a gradual evolution to meet conditions in our own economy. Here is a brief description of the business as it is carried on today:

Member Firms and Personnel

27. As at December 31, 1961, The Investment Dealers' Association of Canada had 189 Members, employing 9,329 persons including shareholders and directors (see Exhibit A).[1] A similar survey taken in August 1958 showed 196 Member firms, employing 8,589 persons (see Exhibit B). These two surveys reveal a reduction in Membership of 7 and an increase in the number of personnel employed of some 8%.

28. The number of office workers required to support one salesman or trader has been rising due to the employment of more specialists, such as analysts, engineers, etc., and the increased paper work involved in producing the gorwing number of reports required for governments and for management. Most of the young men being recruited for sales, underwriting, trading, and research work are university trained. "A CAREER IN FINANCE" issued by the Association in May, 1962, outlines

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1. The Membership as this is written (April 1st, 1962) stands at 190.

the approach to in-service training of employees used by many firms. A copy of this booklet is attached hereto.

29. Membership in the Association has fallen from its peak of 206 in 1955 to its present (April 1962) level of 190. During this period 47 members resigned and 31 new members were accepted. Reasons for resignation are given in Exhibit C.

30. Exhibit A shows that in December 1961, 110 Members had staff of less than 25 and the 1958 Survey suggests that over 60 of these employ 10 persons or less. In this size of business a few senior partners possess the capital, the clientele and the expertise which makes the business possible. This type of enterprise has a very "personal" quality and is more likely than the larger dealer to encounter problems of continuity of management, including the training and retention of able young men to carry on the business.

31. Exhibit A reveals the essentially small-business character of the investment dealing business and the substantial proportion (14.5%) of personnel who are partners or shareholders of Member firms or corporations. The Association has deliberately kept its minimum capital requirement ($25,000) low to encourage applications from small investment houses which can meet our standards as to type of business, character and competence. The owners of investment houses are active in the business and there is no absentee ownership except for eleven firms controlled in the United States and most of the latter have one or more resident directors in charge of Canadian operations.

32. While the investment business is concentrated in the metropolitan areas of Toronto and Montreal, it is well-diversified geographically as revealed by the following table:

Area Served	Number of Members	
1 Province	144	
2 Provinces	25	
3 "	4	
4 "	4	
5 "	4	
6 "	3	
7 "	3	
9 "	2	189
Number of Members with foreign head offices		10
Number of Members with branches abroad		30

The Internal Organization of an Investment House

33. The organization chart given in Exhibit D provides some idea of the internal set-up of the larger investment house. The officers and directors of a typical house of this size include a Chairman, President, 3 - 6 Vice-Presidents (one of whom may be Executive Vice-President) and from 9 - 12 other Directors. Most of these Directors are located in the head office, but some may be in charge of principal branches in other parts of Canada and abroad. Incorporation as a private company is usual with the holding of shares being limited to officers, directors and employees. The total number of shareholders is less than 50 with principal shareholders (5% or over) somewhere in the region of 6 - 10, all of whom will be officers or senior directors. Retirement in the larger houses is usually mandatory at 65 and the retirement of principal shareholders is effected by gradual disposal of their shares starting when the shareholder reaches a stipulated age and continuing until retirement age, by which time the shareholder will have disposed of his entire holding.

34. Since the large investment house has few officers compared to its opposite number in banking and insurance, lines of authority are relatively flexible and frequently a director will fulfill more than one responsibility, e.g., Vice-President in charge of Sales and Syndicating.

As a result of the need for flexibility, there is a wide diversity of practice in the allocation of duties among senior officials and lines of responsibility are frequently blurred. Large investment houses are very individualistic in the way in which management functions are divided, e.g., in some firms the Chairman of the Board plays a dominant role in the management of the firm, in others the post is a recognition of distinguished service and the Chairman is regarded as an elder statesman and counsellor. As we move from the larger investment firm to the medium size and smaller firm we find the senior officials in closer contact with the overall operation of the firm. Thus you may find in the small house that the Secretary-Treasurer is also a Director and his principal occupation may be sales. In the small firm the senior officials are responsible both for policy and direction and active in the day-to-day operation of all phases of the business.

35. Policy establishment and decision making rest with the Chairman...President...Vice-President group, i.e., the senior partners. Underwriting negotiations are usually handled by one of this group and when the informal agreement has been signed other specialists take over. Inventory is the responsibility of a Vice-President usually with limits below which he need not consult his partners. The formulation of investment recommendations to clients is often delegated to a specialist who has ready access to senior officers or may report to a special committee of the Board. Employment of trainees for sales, underwriting, trading and research is typically the care of a senior officer concerned with sales. These observations also hold for the medium size and small house except, as noted earlier, the senior officer in the smaller house is likely to be concerned with all phases of management.

36. Since the investment dealer handles daily cheques and frequently-negotiable securities running into large sums, the industry has developed, over the years, routines of control and checking to protect these assets from loss, theft or conversion. The Association requires Member firms to carry certain minimum fidelity insurance coverage and the firm must

segregate and earmark clients' free securities. Each Member firm is required to select its auditor from a panel approved by the Association's District Auditor. Association By-laws set forth the requirements for the submission of financial statements to the Association's Auditors and any Member which gives concern to the District Auditors are immediately reported to a confidential Audit Committee which has the power to take swift and effective action in correcting the situation. Some larger houses also maintain internal audit facilities which supplement those of the Association. All Member firms select staff carefully and endeavour to the best of the facilities at their disposal to train staff to carry out their duties in an honest and competent manner.

Types of Houses

37. The term "investment dealer" embraces a variety of types of securities business, reflecting in turn the many types of clientele which must be served. It is not possible to list under definite headings the various classifications of dealers as there is always an overlapping as well as a variation in the business transacted by various types. However, in general terms investment dealers may be divided into three groups:

The Integrated Houses which originate, underwrite and distribute government and corporate securities; manage banking and selling groups and participate in other dealers' banking and selling groups; maintain underwriting, sales, trading, portfolio management, statistical, research, accounting and delivery departments and carry on a stock brokerage business or operate an affiliate brokerage firm which is a Member of one or more stock exchanges. Integrated investment houses may be national in scope or operate within a province.

Distributing Houses which do not customarily originate industrial issues, but may purchase municipal issues for distribution on their own account; occasionally may be members of a banking group and typically participate in selling groups; vary from small operations

with a staff of four or five persons to larger firms with substantially the same facilities, aside from underwriting, as the integrated investment houses.

Specialty Houses: in this category are included those firms which concentrate on a particular phase of the investment business. Examples: dealers who specialize in trading in outstanding bond issues; dealers who restrict their trading to stocks which are not listed on the stock exchange; dealers who specialize in municipal, school and religious issues; dealers whose principal business is that of a stockbroker, but do operate a bond department including the services of a bond trader.

Principal Functions

38. The work of the investment dealer can be described under three headings: (1) underwriting and primary distribution; (2) trading and secondary markets; (3) informational, advisory and investment management services.

Underwriting

39. The problem before a would-be issuer of securities whether a government or a corporation is how and on what terms can the capital be obtained. Since there are always a number of approaches to a financing problem one of the principal functions of the dealer is to outline the alternatives and recommend what he considers to be the best one in the current circumstances.

40. The principal types of financing involving the use of the services of an investment dealer are:

(a) The purchase of all or part of an issue at public tender--frequently used with provincial and municipal securities. The dealer estimates the yield at which the issue can be sold, adds his anticipated gross profit and calculates his bid.

(b) A negotiated, underwritten public offering where the issuer and dealer arrive by mutual agreement at the type and terms

of the security to be purchased by the dealer and sold to the public.

(c) A negotiated, underwritten stock offering confined to shareholders with the dealer agreeing to purchase any of the new securities not taken up by the shareholders.

(d) An "option" offering of an issue by a dealer who acts as an agent.

(e) A "private placement" where the investment dealer acts as the agent of the issuer and negotiates the sale to one or a few buyers, usually investing institutions.

41. Whichever method is used, the dealer is frequently called upon to accept two responsibilities: obtain the funds on terms suitable for the issuer and competitive with other issues in the market and, also, ensure that the security is of sufficiently high quality to warrant its offering to his clients.

Government of Canada Market Issues

42. When a new loan has been approved by the Federal Government, the responsibility for effecting the actual distribution is assumed by Bank of Canada. Over the years the Bank has evolved more or less standard procedures for bringing Government of Canada direct and guaranteed loans to the market. These procedures are subject to variation as market conditions change and as new techniques are tested and do not apply to the sale of Treasury Bills or special offerings such as the 1958 Conversion Loan. The Bank maintains a list of investment dealers and banks which are eligible to take part in the primary distribution of new Canada issues. This list is, in effect, a large selling group. Since 1961 the financial community has been given a few days' advance notice of the Government's intention to come to market on a specified date. On the morning of that day each primary distributor receives an "offering wire" from Bank of Canada informing him of the details of the loan, including the amount offered, price, coupon, yield, term, method of offering, commission, deliveries, payment, sub-agents and reports to be made to the Bank and so on. Investment dealers immediately get to work on the new issue and despatch subscription telegrams to the Bank as soon as a decision can be taken. In some issues the Bank offers each primary

distributor a firm allotment which is usually accepted in full. Primary distributors are also permitted to apply for additional bonds, sometimes without limit and sometimes to a maximum which is related to the original allotment. On other issues primary distributors must apply for bonds, calculating how well the loan will be received before entering their application by wire. Some loans are heavily over-subscribed and the primary distributor may only receive a pro-rata allotment of his subscription.

43. On one occasion Bank of Canada, after making allotments of firm bonds, invited primary distributors to tender for additional bonds. In recent months the Bank has been effecting exchanges of securities with the Government, which exchanges partake of the nature of an advance refunding. In such cases the Bank announced that it was open for bids or exchange offers for the issue being made available and apparently accepted or rejected bids and offers on the basis of their individual appeal. Another technique used by the Bank recently is the reselling of new issue bonds which have been acquired directly from the Government, a procedure which to some extent resembles a "tap" loan. The Federal Government has made extensive use of short-term issues during the past two years. As a rule two maturities are offered at a specified price less a concession to primary distributors who subscribe in accordance with the extent of their orders and, in due course, receive confirmation of their allotments.

PROVINCIAL NEW ISSUES

44. New issues of provincial governments are generally sold by private negotiation or by tender. For smaller issues tenders are sometimes invited from two or more syndicates of investment dealers. In 1961, for example, three groups of dealers tendered for a $7.5 million, Province of New Brunswick issue. Large provincial borrowings, in order to obtain the best results from an orderly marketing, are often sold through negotiation to a large syndicate of dealers. Over a long period the Ontario Government and the Hydro Electric Power Commission of Ontario have used this method of marketing. More recently

the Provinces of Quebec, Manitoba and Saskatchewan have adopted this procedure of negotiating with large syndicates in order to achieve market stability for their issues.

45. Provincial requirements for borrowed funds have increased to the point where some provinces have been casting about for new methods of raising capital. A recent innovation has been the issuance by the Provinces of British Columbia, Saskatchewan and Manitoba of Parity Bonds, either direct obligations or guaranteed, cashable at par and accrued interest at specified times each year. A substantial proportion of these bonds were sold by investment dealers on an agency basis and over $300 million have been raised through this method of marketing. Five provinces are issuers of short-term securities which are "rolled over" as they mature.

46. The syndicate which buys the issue is known as the "purchase group". Occasionally the purchase group will invite other dealers to join, at a step-up, in the formation of a banking group to share the liability and in larger issues a selling group is usually formed.

MUNICIPAL NEW ISSUES

47. Most new issues of municipal debentures because of their generally smaller dollar size as compared with provincial issues are sold through sealed bids although many large issues and some smaller ones are sold by private negotiation. The cities of Ottawa and Regina, for instance, after using both methods, currently favour the negotiated sale as the more effective for a city which faces a heavy borrowing programme and thus a recurring need to come to market. A syndicate of dealers which knows in advance that it will have more of that municipality's debentures to sell maintains a continuing interest in the outstanding securities of the municipality and can prepare a good reception for each new issue.

48. The procedure for selling new municipal debentures by the auction method is more or less standard in all provinces. After the nec-

essary legal requirements have been met, a call for tenders is advertised in the Provincial Gazette and/or the daily press in financial centres and a selected list of dealers is circularized. Syndicate managers advise their partners of the forthcoming issue. A meeting is held at which the municipality's statistical record is studied and a representative of the syndicate may visit the municipality for firsthand talks with civic officials and a personal inspection of the community. The saleability of the new debentures is appraised and a bid mutually agreed upon. The bid contemplates a profit to the syndicate adequate to provide for expenses and a risk factor but at the same time the bid has to be pitched high enough to make it competitive.

49. After the bids are open, and without reference to the issuer, the winning syndicate promptly decides among themselves the method of sale and the amount of any concessions or allowances and the formal offering of the securities is made to institutional and other investors. The syndicate may consider it unlikely that they will be able to dispose of the whole of the issue as quickly as desirable or may wish wider geographical distribution than obtainable from syndicate members and decide to form a selling group. The size and make-up of the selling group vary with the issue. In joining a selling group a dealer agrees to abide by the conditions of the offering and can request securities at a discount from the public offering price, and he also agrees to maintain the public offering price set by the syndicate until the issue is sold or until released from the agreement by the manager and to report daily to the manager any unsold balances. Attached to the selling group letter is a list of investing institutions which are "exempt" from the general offering by selling group members. These exempt institutions are contacted by the syndicate members in a manner to avoid duplication of coverage and profits from sales to exempt institutions are for the account of the syndicate and confirmed by the syndicate manager. Where an issue is over-subscribed, the books are promptly closed, allotments made on orders received and confirmations sent out to buyers.

50. The liability of each selling group member is limited to the amount of the new issue which he has requested to purchase. Syndicate members operate on a larger spread but must pay syndicate expenses which

include concessions to selling group members, legal expenses, cost of printing circulars, etc. and since they own the debentures are exposed to risk of loss while distribution is underway.

MONEY MARKET NEW ISSUES

51. Money market securities include Government of Canada treasury bills, Government of Canada bonds and guaranteed bonds with an unexpired term of three years or less to maturity (or to the earliest call date, where a transaction is completed at a premium). Provincial government treasury bills, treasury bills issued by several large municipalities, finance company paper and prime commercial paper are generally classed as being in the money market but are not acceptable for rediscount purposes at the central bank nor eligible for day-to-day loans at the chartered banks.

52. Fourteen investment dealers, active in the money market, and the chartered banks, tender each Thursday for Government of Canada treasury bills. Normally some of these bills are bought against orders and the balance offered to investors and the chartered banks. Provincial and municipal treasury bills and short term coupon notes are purchased both at tender and by negotiation and are sold to investors who have temporary surplus idle cash. In the purchase of prime commercial paper the dealer usually acts as an agent receiving a nominal commission. Transactions in the money market are characterized by large size and a very small margin of profit.

CORPORATE NEW ISSUES

53. Corporation issues generally arise out of direct and private negotiations between an underwriting house and the company. An historical relationship grows up between the dealer and the company, with the dealer having first refusal of any new financing. Among the advantages to a company of such a fiscal agency is the continuing interest of the dealer in the company's financial affairs, continued sponsorship of its securities in the market and the reduction to a minimum of the number of persons with access to company confidential information.

54. The underwriter preparing an issue for a corporation which is coming to market for the first time, makes a thorough investigation of

its financial condition, calibre and continuity of management and future prospects, employing for this purpose such experts as engineers, accountants and management consultants. Negotiations, not infrequently, run on for months before the decision is taken to "come to the market". This trend to a more thorough appraisal is due to the accumulating experience of the underwriting house and is re-enforced by the requirements of professional investors and "full disclosure" securities acts. During the post-war period our underwriting houses have faced and successfully solved many intricate problems of corporation finance. The pool of skill which exists among Canadian underwriting houses is now very considerable and compares favourably with that in the United Kingdom and United States.

55. In going to the public market a corporation has a great number of vehicles available to it, including common and preferred shares, bonds, debentures, convertible securities, securities bearing warrants, a variety of types of sinking funds, serial bonds and term and coupon arrangements, plus a wide range of covenants. The instrument created must be given careful consideration in relation to the capital structure of the company and the current preferences of the market. It is within this milieu of alternative choices that the investment dealer demonstrates his skill and resourcefulness.

56. Once the decision to underwrite is made the representatives of the underwriter and the officers of the issuing corporation prepare and sign an informal agreement covering the significant features of the issue.

57. The question of the offering price and the underwriting compensation are not finally decided until just before the offering. The syndicate manager must correlate all known factors in arriving at a decision, carefully sounding out the probable reception for the issue through talking with his own sales organization and with his banking group associates. He then presents to the financial officers of the issuing corporation his conclusion as to offering price and underwriting compensation. The matter is discussed freely and if no real differences of opinion develop the terms are presented to the Board of Directors and

the arrangement approved. The pricing of the securities is vital — if the manager prices the issue too cheaply he is subject to criticism from the Company when the price rises sharply in the after market. Should he price them too high the banking group will be left with unsold balances on their hands and the issuing company will be critical of the poor reception given its securities.

58. When the approval to issue has been given by the Board of Directors, speed becomes a major consideration and theissuer, the underwriter, counsel for the issuer, counsel for the underwriter, the issuer's auditors, the selected trust company, the printer of the prospectus and the bank note company work together with the goal in mind of producing the following documents: the prospectus, the purchase agreement, syndicate letters, the trust deed or indenture and the debenture certificate.

59. When the prospectus has been approved by all concerned, it is signed by the directors of the company and the underwriters and filed with the appropriate government authorities, including the securities commissions of those provinces in which the underwriter intends to distribute the issue. At the same time, the underwriter is drafting the purchase agreement and, if there is to be a banking group, inviting other houses to join the syndicate. The principal factors governing the selection of dealers to be invited to join the banking group are the issuing company's preference, if any; distributing ability; geographical location of offices; reciprocal business. The banking group agreement which is signed by all participants states the terms, including the price at which the securities are to be sold, under which the distribution is to be effected. Where the syndicate manager deems it advisable a selling group is formed.

60. During the period when selling group terms are in force the manager may move securities from dealers who are experiencing a slow sale to those who need more to fill orders. The duration of syndicate restrictions in the past few years became shorter than previously and it is not uncommon to find a syndicate with a life of less than seven days although in a slow moving issue you may find the restrictions in effect from the time of the official offering to delivery date. When distribution

of the issue has been completed, the selling and banking groups are terminated and each firm's share of the profits after expenses is allotted pro rata.

61. Despite the best efforts of banking and selling group dealers to place securities with investors who will hold them, a certain amount of selling always occurs before delivery date. Some of this stems from speculators who had hoped to make a quick "turn" and some from investors who intended to buy and hold, but due to unforeseen circumstances must sell. To take care of this inevitable selling the syndicate manager may "go short" by an amount which he judges will mop up the return flow of securities. The size of the short position is a fine calculation to be made by an experienced syndicate manager since an excessive short position can lead to serious losses. When the issue is completely distributed, all dealers who participated in the distribution, and especially the syndicate manager, stand ready to provide a secondary market in the issue.

62. Syndicate Managers accept responsibility for the continuing "good health" of securities which they have helped create and distribute. Should a company which has sold its securities to the public through investment dealers develop financial difficulties, the underwriting house will work with the company to solve the problem.

TRADING AND SECONDARY MARKETS

63. The second major function performed by the investment dealer is trading in the secondary market and the maintenance of an inventory of securities which makes it possible to conduct an orderly market. The two principal functions of the secondary market are: (a) to bring buyers and sellers together and (b) to smooth the course of the market by offsetting temporary variations in the demand for and the supply of securities.

64. Secondary market transactions make possible the change in ownership of securities, thus facilitating primary distribution, and establish value levels for outstanding securities. The secondary market consists of two segments: (a) the organized stock exchanges and (b) the

street (also called over-the-counter, between-dealer or unlisted) market. The street market includes all fixed income securities and stocks not listed on stock exchanges. At times, and under certain circumstances, shares listed on a stock exchange may trade between dealers who are not members of the exchange.

65. Here is how the street market operates. Prices on the street market are generally determined by negotiation between buyers and sellers although where there is a series of bids or offers made in the process of reaching agreement there is a degree of auction present. There are approximately 200 dealers and a much smaller number of banks and trust companies active in the street market, which is principally located in Toronto and Montreal. Dealers active in this market have up to 60 direct lines to other dealers, and to an occasional bank, trust company or large institutional client. It is this network of dealers and institutions connected by telephone, teletype and telex which constitutes the market.

66. Trading in the street market is carried on by "traders". In the larger investment house the work is divided among several traders with one handling money market issues, another long Canada's and provincials, another corporates and so on.

67. The sales and trading departments are closely related, with the salesmen asking for quotations for securities which clients wish to buy or sell and traders providing salesmen with this information as well as quotations on securities owned by the firm or available on the street.

68. Speed is an important factor in a successful trading operation and salesmen and traders are positioned close together so that they can inter-communicate quickly. This process is sometimes assisted by a quotation board which immediately reflects all price changes.

69. The Bank of Canada is a major factor in the "street" market and traders in Toronto and Montreal keep in close touch with Bank of Canada representatives in these cities. The Bank does not call a market but "responds" only to firm bids and offerings, hence dealers are

continually phoning the bank to test the market by offering or bidding for blocks of Canada bonds.

70. Market information on price, volume, bids and offers is obtained mostly by word-of-mouth by traders talking to each other, but printed information is also provided by some 25 dealers who issue daily, weekly or monthly quotation sheets, and by the bond quotations which are disseminated by the Association to some twenty dailies and two financial weeklies. The Association's quotes, since they are national, are slightly wider than most dealer markets in retail size.

71. In order to have an effective secondary market there must be a number of dealers who are prepared to take securities into position. A security acquired and held is part of the firm's long position. Inventory may be acquired as a result of a slow-moving new issue which will be gradually disposed of over a period of time, as the result of a conviction that a security represents good value and is a desirable merchandise to offer for sale to clients or as a service to clients who wish to dispose of securities. Size of the inventory carried is directly related to the dealer's capital because of the Association's minimum capital regulations which require the margining of inventory held and also because of the need of the dealer to maintain reserves for possible future commitments. A "short position" arises when a dealer sells a security before he owns it. This may occur in anticipation of price declines, in connection with a new issue as previously described, or because the firm is an active trading house striving to give quick service to a client who wishes to buy.

72. With the growth in importance of institutional investors, the demand for single executions of large size is increasing. Many investing institutions are active traders, exchanging holdings for new issues and moving from one security to another as proposals are "put up" to them by dealers or developed by the officers responsible for managing the portfolio. Where a stock is listed on a stock exchange, permission must be obtained to execute an off-the-board sale. The exchanges permit off-the-board "secondaries" over a stated minimum dollar value because such transactions are beyond the capacity of an auction market to process without disrupting prices.

73. The Investment Dealers' Association assumes responsibility for the supervision of the street market, assisted by the Bond Traders Associations of Toronto and Montreal who provide what day-to-day overseeing is required. Trading Regulations (see Exhibit F) cover such points as good delivery, regular delivery, accrued interest, buy-ins and control of employee trading.

OTHER INVESTMENT DEALER FUNCTIONS

74. Investment dealers provide services ancillary to their principal function of dealing in securities. These include provision of factual information regarding securities and security issuers, advice on investment problems and investment management services.

75. Dealers provide their clients and prospective clients with a continuous flow of information concerning securities, including lists of offerings, market commentaries, quotations, dividends, taxes and called bonds.

76. On request investment dealers also provide advice on specific investment matters including the review of lists of securities and the making of specific recommendations to buy, sell or hold. The quality of this service is related to the firm's research and statistical facilities. 78 of 177 Members reporting state that they maintain a statistical and research department staffed by at least one full-time specialist. 127 Members of 177 reporting advise that they provide portfolio management services to clients. Typically, these are not discretionary accounts, the client being consulted prior to each change in the portfolio. Some dealers impose an annual fee of ½ - ¾% of the value of the portfolio, which fee may be reduced by the total of profits and commissions arising from transactions effected for the account. Usually, however, no charge is made for this service, the dealer's compensation deriving from profits and commissions on transactions made for the client. At least 14 dealers operate investment companies, chiefly invested in equities, whose shares are offered to the general public. Some four dealers maintain pooled funds, participations in

which are available only to clients of the dealer concerned. These pooled funds are designed to offer small clients the advantages of diversification and professional management in the same fashion as a mutual fund.

77. Senior dealer personnel are from time to time called upon to give expert testimony at rate hearings and valuation cases and frequently serve on boards of companies whose securities their firms have distributed.

CONCLUSION

78. The investment business because of its complex character, its need to adapt continuously to changing conditions, its confidential nature, the essentiality of high ethical standards and the substantial sums involved even in run-of-the-mill transactions is a profession as well as a business. It is characterized by narrow gross profit margins and the necessity for developing volume if a house is to grow. In contrast with the financial institutions with which they have common boundaries, investment dealer organizations are small and characterized by a high degree of independence and individuality, in which pattern the views and convictions of senior dealers are predominant.

79. Investment dealers--individually and through their Association--have made a consistent effort during the post-war period (tempered always by the need and desire to consult in a democratic manner with nearly 200 Member firms and corporations) to raise standards of financial capacity, competence and ethical practice. Mr. J. E. Coyne, then Governor of Bank of Canada, in a public address made on December 14, 1959, stated:

> ".....we also have in Canada a well developed nation-wide capital market, particularly in respect of the distribution of securities issued by governments, local authorities and business corporations. This is primarily the field of activity of investment dealers. I think there is little doubt that the financial machinery existing in Canada for the placing of new issues of securities on the market is the equal of that of any country in the world and, in proportion to our size, it probably arranges, year in and year out, for the provision of a greater quantity of new capital to those requiring it than is the case in any other country in the world. The results achieved are a reflection of the industry and enterprise and broad national outlook of our investment dealers....."

- End -

PART I - EXHIBIT "A"

PERSONNEL DATA

Notes: (1) This summary shows the total number of full-time staff employed by Members as at December 31, 1961.

(2) Members incorporated in, or with principal office in Canada, included entire staff, Members incorporated, or with principal office outside of Canada, included only staff employed in Canada.

(3) Summary includes only personnel engaged in the securities business.

	Range							
	1 - 24		25 - 99		100 and Over		Total	
	No.	%	No.	%	No.	%	No.	%
Salesmen and Saleswomen	346	28.1	613	25.1	1,309	23.1	2,268	24.3
Sales Trainees	12	0.9	47	1.9	134	2.4	193	2.1
Trading:								
Bond Traders	54	4.4	77	3.2	148	2.6	279	3.0
Stock Traders	53	4.3	125	5.1	190	3.4	368	3.9
Other trading personnel	36	2.9	165	6.8	396	7.0	597	6.4
Underwriters	8	0.6	27	1.1	65	1.1	100	1.1
Analysts and Statisticians	12	1.0	67	2.7	105	1.9	184	2.0
Other specialists	1	0.1	9	0.4	30	0.5	40	0.4
Senior Administrative	227	18.5	252	10.3	340	6.0	819	8.8
Accounting and Delivery Personnel	249	20.3	509	20.8	1,549	27.4	2,307	24.7
All others	232	18.9	552	22.6	1,390	24.6	2,174	23.3
Total Personnel	1,230	100.0%	2,443	100.0%	5,656	100.0%	9,329	100.0%
Number of the above total who are shareholders (if a limited company) or partners (if a partnership)	365	29.7%	426	17.4%	562	9.9%	1,353	14.5%
Number of Members reporting	110		52		24		186	

IDAC - PERSONNEL SURVEY - AUGUST 29, 1958.

TABLE "A"

	No. of Staff 1 - 10		No. of Staff 11 - 25		No. of Staff 26 - 50		No. of Staff 51 - 100		No. of Staff 101 - 200		No. of Staff Over 200		Totals	
Number of Firms in Group	66		56		30		26		9		9		196	
		%		%		%		%		%		%		%
Shareholders and Partners	167	41.3	244	25.4	201	19.0	218	12.8	153	10.9	280	9.1	1,263	14.7
All other staff	237	58.7	715	74.6	853	81.0	1,490	87.2	1,254	89.1	2,777	90.9	7,326	85.3
Totals	404	100%	959	100%	1,054	100%	1,708	100%	1,407	100%	3,057	100%	8,589	100%

Note: 193 Member Firms responded
1 Member Firm did not respond
2 Member Firms filed combined returns for their investment firm and stock affiliate.

PART I - EXHIBIT "B"

TABLE "B"

	No. of Staff 1 - 10		No. of Staff 11 - 25		No. of Staff 26 - 50		No. of Staff 51 - 100		No. of Staff 101 - 200		No. of Staff Over 200		Totals	
Number of Firms in Group	66		56		30		26		9		9		196	
		%		%		%		%		%		%		%
Salesmen	100	24.8	264	27.5	274	26.0	378	22.1	343	24.4	634	20.7	1,993	23.2
Saleswomen	3	.7	6	.6	6	.6	2	.1	8	.6	5	.2	30	.3
Sales Trainees	1	.2	12	1.3	19	1.8	31	1.8	32	2.3	62	2.0	157	1.8
Bond and Unlisted Stock Traders	24	5.9	48	5.0	46	4.4	76	4.4	45	3.2	99	3.2	338	3.9
Floor Traders	-	-	52	5.4	49	4.6	73	4.3	41	2.9	44	1.4	259	3.0
Underwriters	8	2.0	4	.4	20	1.9	14	.8	15	1.1	53	1.7	114	1.3
Analysts and Statisticians	2	.5	17	1.8	33	3.1	36	2.1	30	2.2	61	2.0	179	2.1
Accounting and Delivery Personnel	55	13.6	178	18.6	203	19.3	358	21.0	337	23.9	672	22.0	1,803	21.0
Other Specialists	-	-	2	.2	3	.3	15	.9	12	.9	23	.8	55	.7
Senior Administrative	116	28.7	143	14.9	131	12.4	155	9.1	71	5.0	107	3.5	723	8.4
All others	95	23.6	233	24.3	270	25.6	570	33.4	473	33.5	1,297	42.5	2,938	34.3
Totals	404	100%	959	100%	1,054	100%	1,708	100%	1,407	100%	3,057	100%	8,589	100%

PART I - EXHIBIT "C"

CHANGES IN I.D.A.C. MEMBERSHIP: APRIL, 1955 - MARCH, 1962

	New Members	Resignations
1955 - 1956	4	4
1956 - 1957	1	8
1957 - 1958	8	5
1958 - 1959	1	9
1959 - 1960	7	9
1960 - 1961	7	4
1961 - 1962	3	8
	31	47

Reason for Resignation:

Going out of business (1)	20
Dual members resigning (2)	9
Dual members merging (2)	2
Business sold to another Member	7
Inability to meet I.D.A.C. requirements	5
Resigned and later rejoined	2
Business sold to new interests and character of business changed	2
	47

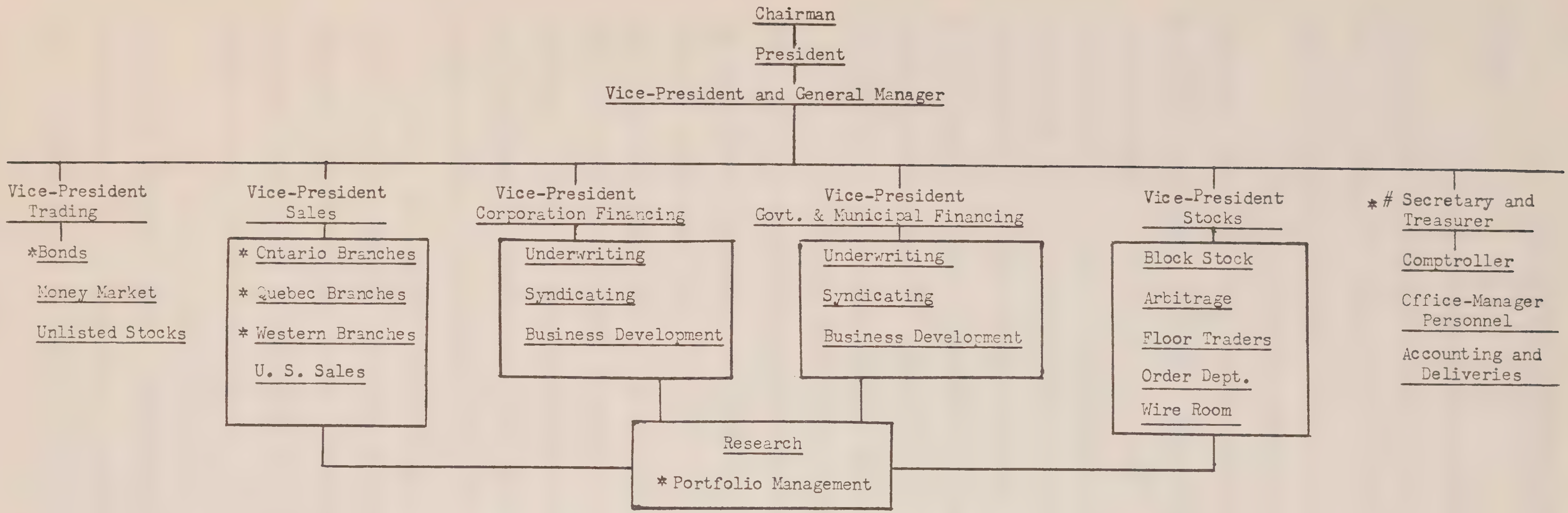
Notes:

(1) Death or retirement of a senior partner or principal contributor of capital was the most common reason for going out of business. In many cases one or more of the partners or directors of the resigning firm eventually become associated with other member firms or corporations.

(2) At one time the Association had a number of "dual" memberships where both the investment dealing organization and the affiliated stock exchange organization held memberships. Canges in the way of doing business resulted in 9 stock exchange houses resigning. In 2 cases the stock business was merged with the investment business in one company.

EXHIBIT "D"

ILLUSTRATIVE ORGANIZATION PLAN FOR THE LARGER INVESTMENT HOUSE



NOTES:

1. ( ) indicates function usually in charge of a director. A director may be responsible for more than one function.

2. United States sales and stock business are frequently handled through an affiliated firm or corporation.

3. Some investment houses use an Executive Committee of the Board. Some houses designate the Senior Vice-President as "Executive Vice-President.

4. Advertising brochures, etc. are usually the responsibility of an official in the sales or underwriting department.

5. (#) At least one Member has a Vice-President, Finance.

PART II

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

HISTORY

1. The Investment Dealers' Association of Canada was formed in June 1916 under the name Bond Dealers' Association of Canada. It was the result of a merger of a group of bond dealers in Montreal and the financial section of the City of Toronto Board of Trade.

2. The Association originally started with 32 Members, all except one having their Head Office located in either Toronto or Montreal. By 1920 the membership had grown to 104 firms, many with branches located across the country. The Association could be said by that date to have attained National stature. The name Bond Dealers' Association of Canada was felt not to be descriptive of the diverse and expanding business carried on by the Members of the Association. In 1925 the name was changed to The Investment Bankers' Association of Canada and the Members of the Association began to refer to themselves as Investment Bankers, thus following the nomenclature in general use in the United States.

3. In 1934 the Bank Act was changed and one of the amendments was to restrict to Chartered Banks the use of the names Bank or Banker. It was accordingly necessary to search for an alternative name for the Association to desribe the type of business carried on by its Members. The term Investment Dealer was decided upon, the name of the Association became The Investment Dealers' Association of Canada and Members were encouraged to refer to themselves as Investment Dealers. The term is now widely accepted in Canada and official recognition has been given to it in the Securities Acts of several of the Provinces.

4. By 1939 the Association had a membership of 130 located across Canada and was in a favourable position to co-operate with the Government in the emergency of war. The National War Finance Committee included a large number of Investment Dealers who played a vital role in the financing of Canada's war effort.

5. Since the end of World War II the Association has continued to grow and expand its scope. After reaching a peak of 208 Members in 1958 the membership has now levelled off, owing mainly to mergers and buy-outs, to 189 Members. Although some slight reduction of this number

may be expected, the outlook for the foreseeable future is that this approximate membership will be maintained. Exhibit A shows the Members of the Association as at 31st January, 1962.

6. Since its inception, the Association's Head Office has been maintained in Toronto. In 1947 a Branch Office was opened in Montreal to serve the needs of the Members in that city and throughout the Province of Quebec. This office has now become an essential part of the Association and has done much to establish and maintain its national character. Recently a French translation of the Association's name has been approved and Members in the Province of Quebec are encouraged to make use of this name as well as the English version.

7. In 1947 an Education Programme was started for the employees of Members and for the general public. Two correspondence courses for employees and a number of courses of various types for the public, are now offered by the Association. Work on a third employee course is at present in progress. In keeping with the National aspect of the Association one of the employees' courses and a number of the courses for the general public are available in French, and all course assignments may be answered in French.

STRUCTURE AND ORGANIZATION

(a) Constitution and By-laws

8. Membership in the Association is governed by its Constitution and By-laws. The Association is an unincorporated non-profit body. The Constitution and By-laws may from time to time be repealed, amended or re-enacted by the National Executive Committee of the Association, subject always to the approval of the Members passed at a General or special meeting of the Association, by an affirmative vote of two-thirds of the votes given on such Resolution. They encompass the basic philosophy and operations of the Association and allow the making of Regulations pursuant to the By-laws for the day to day operations of the Association and its Members.

9. The right to apply for Membership in the Association is open to all individuals, firms or corporations carrying on business in Canada as Investment Dealers, provided that the business of the applicant is of such character that at least half of the gross profits of such business

for the twelve month period immediately prior to application resulted from, or consisted of, the underwriting, distributing or buying and selling, either as principal or agent, from and to the public in Canada, of investment securities including bonds, debentures, notes and shares of an investment character. In addition, at least 50% of the principals of all applicants for Membership must have been in the investment business for at least five years, and all applicants must possess a minimum of $25,000 liquid capital plus such extra capital as may be required to allow them to hold inventory, carry margin accounts and carry on other operations necessary to their business.

10. An applicant for Membership in the Association is first screened by the local District Executive Committee, and providing it satisfies the requirements of By-law No. 1 of the Association and is approved by the Committee, notice of the application is given to all Members who have a period of time in which to object to the applicant. If there is no objection, the application is referred to the National Executive Committee for their final decision.

11. During the forty-six years of its existence, the Association's By-laws have been continually amended to reflect the changing standards and requirements of the industry, and there have been periodic reviews of the Membership requirements with particular reference to standards of ethics, type of business transacted and financial position.

12. Exhibit B contains the Constitution and By-laws of the Association, and Exhibit C the Regulations of the Association, except the Trading and Delivery Regulations.

(b) Organization

13. The Investment Dealers' Association of Canada is a National organization, but in keeping with the size and diversity of Canada it is divided into six Districts, as follows: Atlantic District (Provinces of Newfoundland, New Brunswick, Nova Scotia and Prince Edward Island); Quebec District (Province of Quebec); Ontario District (Province of Ontario); Mid-Western District (Provinces of Manitoba and Saskatchewan); Alberta District (Province of Alberta); and Pacific District (Province of British Columbia). Each district is under the direction of a

Chairman and District Executive Committee, the District Chairmen being Vice-Presidents of the Association and comprising, along with the President and Immediate Past President, the National Executive Committee. In addition, each district has a District Business Conduct Committee comprised of the District Chairman, the past five District Chairmen still active in the investment business, and the Managing Director. Appeal lies from this Committee to the National Business Conduct Committee which is made up of the Immediate Past President and the four previous Past Presidents still active in the business. The Association and each District appoints auditors and the Association retains Counsel in Toronto and Montreal.

14. The permanent Executive staff of the Association is made up of a Managing Director, Secretary-Treasurer, Director of Education, Regional Director and Secretary Emeritus.

15. Exhibit D lists the Officers, Committees and Auditors of the Association for the year 1961-62 and the Past Presidents of the Association since its inception.

(c) Comparison With United States and United Kingdom Associations

16. The Investment Dealers' Association of Canada is not directly comparable to securities organizations or associations in other countries. Although in their early days the Investment Bankers Association of America and The Investment Dealers' Association of Canada were similar in their function, over the years the two Associations have developed along somewhat divergent lines.

17. Membership in the Investment Bankers Association of America represents only a small percentage of the securities dealers in that country (approximately 15% of the nearly 5,000 securities dealers). In the United States there is Federal Securities Legislation in addition to the Securities Legislation in the various States and membership in the U.S. Federal Government sponsored and controlled National Association of Securities Dealers is compulsory for all securities houses in the country. The Investment Dealers' Association of Canada performs some of the functions of both these Associations. In Canada there is no Federal Securities Legislation other than companies

legislation and the Securities Acts under which Investment Dealers operate are provincial statutes. In the Securities Acts of the Provinces of Ontario, Alberta and Saskatchewan, the Association is specifically referred to, and is given certain rights and responsibilities thereunder. A number of other Provincial Securities Acts are at present under review, and it seems likely, in at least one other Province, that the Association will be granted similar rights and responsibilities.

18. In the United Kingdom there is no organization or association comparable to The Investment Dealers' Association of Canada. The Issuing Houses Association performs a somewhat similar function in the field of new issue underwritings. There, however, any comparison ends. The secondary market in securities owned as principal, is, in the United Kingdom, carried on by jobbers, and these firms come under the control of the London or other Stock Exchange on which they operate.

FUNCTIONS

19. The principal functions of The Investment Dealers' Association of Canada are as follows:

(i) Protection of the Investing Public;
(ii) Mutual Protection of Members;
(iii) Maintenance of High Ethical Standards;
(iv) Maintenance of Orderly Marketing and Trading;
(v) Education of Members' Employees and the Public;
(vi) Provision of Statistical Data;
(vii) Publications;
(viii) Liaison with Other Financial Institutions.

(i) Protection of The Investing Public

20. Investment Dealers are concious of their responsibilities to the investing public, both to institutions and to the ordinary citizen. They endeavour to maintain highest standards of ethics and reliability, and to ensure that all members of the public receive expert advice and completely fair treatment. The Association attaches the greatest importance to this.

21. At all times the Association has endeavoured to keep the interests of the nation and the investing public to the forefront. The

Association has been outspoken in its attempts to ensure that investors are fairly and equitably treated by Corporations and Governments alike, particularly during financial reorganizations.

22. In particular, the Association controls in its By-laws and Regulations the type of business carried on by its Members or to be carried on by new Members, and the minimum financial requirements of its Members or of new Members.

23. (a) Type of Business - The By-laws require that all Members of the Association and applicants for membership, must derive at least 50% of their profits from the underwriting, distributing, or buying and selling, either as principal or agent, from and to the public in Canada, of investment securities (including bonds, debentures, notes and shares of an investment character) as defined in the By-laws. At the discretion of the applicable District Executive Committee, a Member (or applicant) may submit its dollar volume rather than profits. Applicants who have not been in business in Canada for at least one year may be admitted to membership on an estimate of their proposed business, but are liable to six-monthly reviews on the type of business they conduct for two years after admission to the Association. All Members are liable to periodic routine reviews on the type of business they conduct, and at the discretion of either the National Executive Committee or the applicable District Executive Committee may be required to submit special reviews.

24. The By-laws define investment securities to include (i) government, municipal, hospital, school, corporations and religious institutions, bonds, debentures, notes and other securities not in default of principal or interest; (ii) preferred shares not in arrears of dividends; (iii) such common shares with demonstrated earning power whether or not dividend paying, such shares in Investment Companies, and such other securities as the applicable District Executive Committee, with the concurrence of the National Executive Committee, may from time to time approve as investment securities.

25. Exhibit E consists of the Application for Membership form and the form used when requiring Members to submit a breakdown of the type of their business.

26. (b) Minimum Financial Requirements - All Members of the Association are required to maintain minimum capital in accordance with the type and magnitude of operations carried on. The minimum liquid capital which is to be maintained must be at least $25,000, but this has to be supplemented, and such liquid capital must be at least sufficient to provide an adjusted liquid capital equal to the sum of

(i) 2% of the Member's current liabilities or $50,000 whichever is less;

(ii) 2% of the Member's adjusted liabilities;

(iii) Such additional amount as may be required if a Member does not deposit all clients' free credit balances in a Clients' Trust Account or carries margin accounts for clients or sells securities on an installment payment plan.

In the case of a large national or international house carrying on a fully diversified Investment Dealers' business, the total amount of minimum capital required would be very substantial. Members are obliged to segregate clients' securities held in safekeeping from their own securities, and to carry minimum insurance coverage.

27. By-law 8A of the Association and the Regulations of the National Executive Committee made pursuant thereto, outline the minimum capital requirements of the Association. By-law 8C and the Regulations of the National Executive Committee made pursuant thereto, contain the insurance requirements of the Association. (Refer to Exhibits B and C.)

(ii) Mutual Protection of Members

28. In common with other trade associations, one function of The Investment Dealers' Association of Canada is the protection of its Members. Every effort is made to foster the interests of the Investment Dealer, and the Association, when required, submits briefs and recommendations on behalf of the industry to the appropriate authorities.

(iii) Maintenance of High Ethical Standards

29. The speed at which securities transactions take place makes it impractical for each sale or purchase to be confirmed in writing at the time. Shares or bonds are bought and sold by word of mouth, either personally or over the telephone, and although confirmed

by letter as soon as possible (usually the same day) this confirmation is not received by the other party until the next day at the earliest. However, failure to honour these verbal contracts is extremely rare, and the word of an Investment Dealer is regarded as his bond.

30. Although Members of The Investment Dealers' Association of Canada have built up an enviable record for their ethics, nevertheless infringements of ethics or of the Association's Rules and Regulations do take place. A District Business Conduct Committee is set up in each District to hear and investigate fully any complaints against Members of the Association. Not only is the structure of these committees such that only senior members of the industry serve on them, but in all important matters the opinion of counsel is sought, thus helping to ensure that the Rules and Regulations of the Association are fairly and impartially enforced and that high ethical standards are maintained. There is appeal to the National Business Conduct Committee, which consists of five Past Presidents of the Association.

31. The Association feels, particularly since the amendments to the Disciplinary By-laws in October, 1961, that all complaints against Members have been quickly and fairly dealt with by the appropriate committee or committees. In the past two years two Members of the Association have been suspended and three Members have been fined.

(iv) Maintenance of Orderly Marketing and Trading

32. The Investment Dealers' Association of Canada exercises the ultimate responsibility for the manner in which secondary trading in Treasury Bills, bonds, debentures and unlisted shares in Canada is conducted. Day to day control over this trading is exercised respectively in Toronto and Montreal by the Toronto Bond Traders' Association and the Montreal Bond Traders' Association. These two associations are composed of representatives of Investment Dealers, Chartered Banks and certain other financial organizations.

33. Both Bond Traders' Associations are subsidiary to The Investment Dealers' Association of Canada and agree in their By-laws or Regulations to be bound by the decisions of the Association as regards

to unlisted trading. In practice, all routine matters are handled by the committees of the two Bond Traders' Associations, whose decisions are normally final. However, any Member of The Investment Dealers' Association of Canada who is dissatisfied with a ruling of one or other of the Bond Traders' Associations is entitled to bring the matter before the District Executive Committee of The Investment Dealers' Association of Canada who, through their Bond Traders' Liaison sub-committee, would investigate the matter. The Bond Traders' Associations make such rules and regulations as they feel necessary and desirable for orderly trading, and although these provisionally go into force when passed, they are referred to The Investment Dealers' Association of Canada for confirmation, and if not so confirmed would lapse.

34. Exhibit F contains the Trading and Delivery Regulations of The Investment Dealers' Association of Canada.

35. The Investment Dealers' Association of Canada maintains close liaison and contact with the Government of Canada, the Bank of Canada, and the Provincial Governments and Securities Commissioners. This contact is not only established and maintained by the elected Officers immediately on taking office, but is maintained on a continuing basis by the Managing Director and other permanent Officers of the Association.

(v) Education of Members' Employees and the Public

36. From its inception in 1947, the I.D.A.C. education programme has been rapidly expanded and now covers two distinct areas. A comprehensive internal education programme has been developed to speed the training of new employees within the industry in many of the complexities of the investment business and thereby to equip them to serve the public better. An external education programme has also been developed to acquaint the Canadian investing public with the fundamental terms, procedures and principles of sound investment management. The Association employs a full-time education officer to direct both programmes.

(a) Internal Education

37. The Association's internal education programme is founded on two correspondence courses entitled "Principles and Practices of

Investment Finance in Canada." Both courses were written by experts in the industry and both are revised and have new assignment questions added each year. Course I is designed for all new employees of Member firms, though it is also made available to members of most other financial institutions and to financial employees of Canadian corporations. It covers such topics as elementary accounting, the interpretation of financial statements, the characteristics of various types of investment securities, the origination and trading of securities, I.D.A.C. regulations and the Provincial Securities Acts. Course II is at present restricted to employees of Investment Dealers, members of Canadian stock exchanges and editorial employees of the financial press. This course leads the student into more detailed financial analysis and covers corporate, provincial and municipal underwriting and security distribution; the operations of the Bank of Canada; the money market; portfolio management and salesmanship.

38. The material for these two courses is mailed to students at regular intervals during the year and within a specified time completed assignments must be submitted. These are marked and graded and at the end of each Course there is a compulsory examination. To date, with some 5,996 persons having enrolled in the two courses, a total of 3,601 have successfully completed the programmes. Exhibit G shows the cumulative record of course results.

39. At the time of writing, a third course for Members' employees is being prepared. This course will outline the banking, accounting, contractual, regulatory and legal aspects of the investment business.

(b) <u>External Education</u>

40. Each year the Association prints and distributes to the general public a revised edition of its Home Study Correspondence Course "How to Invest Your Money in Bonds and Stocks." This course covers such subjects as bonds and debentures, preferred and common shares, the interpretation of financial statements and portfolio management. At present, the course is distributed to the public through the Universities of Western Ontario and Saskatchewan in English, and Laval University

in French. It has received wide distribution both in Canada and abroad. A total of some 18,000 persons have enrolled in the English language version and approximately 2,000 in the French edition. Commencing September, 1962 the Association itself intends to take over distribution of the English edition of the course in an attempt to obtain even wider public distribution.

41. The Association maintains across the country active voluntary Speakers' Panels composed of Members' employees. Speeches are given on request to a large number of organizations including universities, schools, service clubs, women's associations, trade and professional bodies. About 100 public addresses have been arranged by the Association during the past year.

42. In 1954 the Association produced a film entitled "A Matter of Importance." It stresses the importance of an investment programme to a typical young Canadian family. This film is available to Members of the Speakers' Panel where it has received over 300 showings. It has also been widely screened on television across the country.

43. Our public educational programme also includes lecture courses for employees of Canadian companies and evening lecture courses for the general public held in co-operation with a number of Canadian universities, school boards and other educational bodies. Exhibit H shows that over 1,700 Canadians were enrolled in these courses during the past year.

44. In the Spring of the past seven years the Association has co-operated with the Toronto and Montreal Stock Exchanges in week-long visits of staff members of the commerce and finance departments of Canadian universities. This programme has given over 50 Canadian university professors an intimate glimpse of the operations of Member firms and helped to broaden their understanding of the investment industry's role in the continued growth of our economy.

45. For the past few years several of our larger Members have also played host to visiting high school teachers and guidance counsellors. These visits have helped acquaint the teachers with career opportunities in the investment business for their commercial and business graduates and assisted the industry in recruiting promising

junior personnel.

(vi) Provision of Statistical Data

46. Apart from an employee survey completed in 1958 and several surveys conducted in preparation for this Brief, the Association has attempted little in the way of gathering statistical data on the operations of its Members. This failure has been the result of the formidable problems involved in gathering reliable statistical information. It has become apparent that no two firms within the Association keep their books in the same way. For example: fiscal-year-ends among our Members fall throughout the calendar year; some firms record sales on transaction dates, others on delivery dates; and no two firms have precisely the same business "mix" between the institutional, retail, money market, bond and stock aspects of their business.

47. The Association is hopeful, however, that a full and accurate statistical picture of the industry will soon emerge. A recent request from the Dominion Bureau of Statistics for further factual data as well as similar requests from the present Royal Commission have made many Members aware of the poverty of statistical information presently available and the value it would have for all concerned. The Association's new education course currently under development is also expected to help in standardizing accounting practices within the industry and make regular statistical collection and periodic statistical reviews more readily obtainable.

48. Nevertheless, since 1960 the Association has collected from its Members, through its District Auditors, a total of Members' borrowings outside the banking system and the Bank of Canada by any method on the collateral of securities owned by the Member, including day-to-day, call and term loans, buy-backs and re-purchase agreements where the aggregate total of such borrowing is in excess of $500,000. These totals are available to Members on request every Friday morning. They are also released on a confidential basis to the Bank of Canada, the Department of Finance and the Dominion Bureau of Statistics.

49. Similarly, the Association co-operates with the Dominion Bureau of Statistics in obtaining, assembling and distributing

statistics showing the sales and purchases of securities between Canada and other countries. These are reproduced and circulated to all Members of the Association. For an example, see Exhibit I.

50. Each business day, the bid and asked quotations on leading corporation, government and overseas bonds are gathered from Member firms and distributed nationally to the financial press. Weekly reports on the domestic bond market are also supplied to Canadian Press and the Canadian Broadcasting Corporation.

(vii) Publications

51. For the convenience of its Members, the Association maintains a Directory of Members brought up-to-date twice yearly. This Directory lists all the Members of the Association with their branches, wire communications, partners, officers and directors. Exhibit J is the Association's Directory of Members.

52. The Association currently issues four other publications for distribution to Members and to the general public. These are as follows:

* "Canada and Canadian Provinces, Funded Debts Outstanding" - This book is published annually with half yearly supplements and at present about 17,000 copies of each are distributed each year.
* "How to Read Financial Statements" - Designed for the novice investor, this publication first appeared in 1958 and over 42,000 copies have now been distributed.
* "Investment Terms and Definitions" - Also for the novice investor, this booklet has been in print, with periodic revisions, for over 15 years. Some 60,000 copies of it have now been distributed.
* "A Career in Finance" - This publication tells the high school and university graduate about career opportunities in the investment industry. It has recently been completely rewritten and 15,000 copies of the new version are now being printed.

Exhibit K contains copies of these four publications.

(viii) Liaison with Other Financial Institutions

53. The Investment Dealers' Association of Canada maintains liaison with the leading Stock Exchanges in the country. Three districts (Quebec, Ontario and Pacific) maintain Stock Exchange Liaison sub-committees and consultation with the local Stock Exchanges takes place on matters concerning the functioning of the financial industry.

54. The Association also liaises and maintains contact with The Canadian Bankers' Association, The Trust Companies Association of Canada, The Dominion Mortgage and Investments Association, The Canadian Life Insurance Officers Association and other Associations in Canada concerned with the investment industry.

55. Abroad, the Association maintains contact and exchange of information with the Investment Bankers Association of America, and some 32 Members of the Association are also Members of the Investment Bankers Association of America.

Trends And Indications For the Future

56. In the years ahead the Association intends to expand and refine its internal education programme to equip employees of Member firms to serve the public better. Moves towards a broader programme of public education may also be expected. To strengthen the protection given to the investing public, the Association intends to maintain and improve its Members' standard of ethics and type of business by further tightening of existing regulations on membership and discipline. Finally, the Association hopes to embark on a fuller and more regular programme of statistical collection and reporting which should assist our Members, government bodies and other interested parties in understanding the ever-changing nature of our business.

OFFICERS AND COMMITTEES

of

The Investment Dealers' Association of Canada

Head Office
55 Yonge Street, Toronto

Regional Office
132 St. James Street West, Montreal

OFFICERS, 1961-62

President
Arthur J. Milner
Mills, Spence & Co. Limited, Toronto

Vice-Presidents

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Eastern Securities Company Limited,
Halifax.

W. M. Reay,
Nesbitt, Thomson and Company, Limited,
Montreal.

D. S. Beatty,
Burns Bros. & Denton Limited,
Toronto.

D. J. Langill,
W. C. Pitfield & Company, Limited,
Winnipeg.

K. M. Johnston,
Wood, Gundy & Company Limited,
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Royal Securities Corporation Limited,
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The Investment Dealers' Association of Canada,
Toronto.

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The Investment Dealers' Association of Canada,
Toronto.

Secretary Emeritus

J. A. Kingsmill,
The Investment Dealers' Association of Canada,
Toronto.

Auditors

Eakins and MacDonald,
Toronto.

Honorary President

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Wood, Gundy & Company Limited,
Toronto.

Honorary Treasurer

J. Edgar Hill,
Royal Securities Corporation Limited,
Montreal.

Assistant Director of Education

Eric A. Harvie,
The Investment Dealers' Association of Canada,
Toronto.

Regional Director

L. F. Almond,
The Investment Dealers' Association of Canada,
Montreal.

Counsel

R. O. Daly, Q.C.,
Daly, Harvey & Cooper,
Toronto.

G. B. Foster, Q.C.,
Foster, Hannan, Watt, Leggat & Colby,
Montreal.

NATIONAL EXECUTIVE COMMITTEE

(The President, the Vice-Presidents and the Immediate Past President comprise the National Executive Committee.)

ARTHUR J. MILNER, Toronto.
J. WILLIAM RITCHIE, Halifax.
W. M. REAY, Montreal.
D. S. BEATTY, Toronto.
D. J. LANGILL, Winnipeg.
K. M. JOHNSTON, Calgary.
ROSS WILSON, Vancouver.
ERIC S. MORSE, Montreal.

DISTRICT EXECUTIVE COMMITTEES, 1961-62

ATLANTIC DISTRICT

J. WILLIAM RITCHIE, *Chairman*	Eastern Securities Company Limited	Halifax
H. D. SCULLY, *Vice-Chairman*	Nesbitt, Thomson and Company, Limited	Saint John
C. E. ASPREY	F. J. Brennan & Company Limited	Charlottetown
ADRIAN BRIDGEHOUSE	Gairdner & Company Limited	Halifax
GERALD R. COYLE, *Secretary-Treasurer*	Wood, Gundy & Company Limited	Halifax
J. D. INCHES	Royal Securities Corporation Limited	Saint John
WILLIAM C. LEE	Stanbury & Company Limited	Halifax
D. C. MACKAY	W. C. Pitfield & Company, Limited	Saint John
W. P. MACMURRAY	Eastern Securities Company Limited	Saint John
JOHN M. ROBINSON	W. C. Pitfield & Company, Limited	Halifax
ELLIOTT SPAFFORD	Cornell, Macgillivray Limited	Halifax
J. A. MACMURRAY, *Ex-officio*	Eastern Securities Company Limited	Saint John

QUEBEC DISTRICT

W. M. REAY, *Chairman*	Nesbitt, Thomson and Company, Limited	Montreal
J. P. W. OSTIGUY, *Vice-Chairman*	Morgan, Ostiguy & Hudon Ltd.	Montreal
H. W. ANDREWS	Graham, Armstrong Securities Ltd.	Montreal
B. E. DE BREYNE	L. G. Beaubien & Co. Limited	Montreal
M. DAVID	Crédit Interprovincial Inc.	Montreal
D. DLOUHY	La Maison Bienvenu Limitée	Montreal
G. FALARDEAU	J. T. Gendron Inc.	Quebec City
L. HESLOP	Bell, Gouinlock & Company, Limited	Montreal
L. P. LETARTE	La Corporation de Prêts de Québec	Quebec City
R. W. MACKEEN	Greenshields Incorporated	Montreal
W. G. PAVEY	W. C. Pitfield & Company, Limited	Montreal
W. A. STEWART	Midland Securities Corpn. Limited	Montreal
J. EDGAR HILL, *Ex-officio*	Royal Securities Corporation Limited	Montreal

ONTARIO DISTRICT

D. S. BEATTY, *Chairman*	Burns Bros. & Denton Limited	Toronto
D. R. ANNETT, *Vice-Chairman*	Annett & Company Limited	Toronto
PHILIP J. CHADSEY	Wood, Gundy & Company Limited	Toronto
M. D. COX	Anderson & Company Limited	Toronto
ROBERT W. GOUINLOCK, JR.	Bell, Gouinlock & Company, Limited	Toronto
J. ROSS HILBORN	McLeod, Young, Weir & Company Limited	Toronto
WILLIAM N. HOVEY	Equitable Securities Canada Limited	Toronto
E. P. JARVIS	Wisener, Mackellar and Company Limited	Toronto
L. E. MAYHEW	Harris & Partners Limited	Toronto
J. D. SCHULTZ	Dominion Securities Corporation Limited	Toronto
C. R. SLIPP	Wills, Bickle & Company Limited	Toronto
D. I. WEBB	Merrill Lynch, Pierce, Fenner & Smith Incorporated	Toronto
D. B. SHAW, *Ex-officio*	A. E. Ames & Co. Limited	Toronto
A. J. MILNER, *Ex-officio*	Mills, Spence & Co. Limited	Toronto
ROY W. HARDAKER, *Ex-officio*	Cochran, Murray & Co. Limited	Hamilton
C. E. MEDLAND, *Ex-officio*	Wood, Gundy & Company Limited	Kitchener
R. A. MACDONALD, *Ex-officio*	A. E. Ames & Co. Limited	London
V. S. CASTLEDINE, *Ex-officio*	V. S. Castledine & Company Limited	Ottawa

MID-WESTERN DISTRICT

D. J. LANGILL, *Chairman*	W. C. Pitfield & Company, Limited	Winnipeg
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M. J. BULFORD	Greenshields Incorporated	Winnipeg
W. LYLE DYKER, *Secretary*	Osler, Hammond & Nanton Limited	Winnipeg
W. E. HEAVER	Nesbitt, Thomson and Company, Limited	Regina
JOHN GRAHAM, JR.	Bell, Gouinlock & Company, Limited	Winnipeg
W. A. KINCH	Dominion Securities Corporation Limited	Winnipeg
A. K. MCCORD	A. E. Ames & Co. Limited	Winnipeg
J. A. MACKNIGHT	James Richardson & Sons	Winnipeg
W. S. DUNLOP, *Ex-officio*	Oldfield, Kirby & Gardner Limited	Winnipeg

ALBERTA DISTRICT

K. M. JOHNSTON, *Chairman*	Wood, Gundy & Company Limited	Calgary
O. E. BUKER	James Richardson & Sons	Calgary
R. COPITHORN	W. C. Pitfield & Company, Limited	Edmonton
DENNIS BESSEX	Nesbitt, Thomson and Company, Limited	Calgary
LLOYD J. KNOWLER	Osler, Hammond & Nanton Limited	Edmonton
HAROLD MACKEEN	Toole, Peet Investments, Limited	Calgary
WILLIAM MATHEWSON	McLeod, Young, Weir & Company Limited	Calgary
R. MONTAGUE	Dominion Securities (Alberta) Limited	Edmonton
HOWARD RITCHIE	Sydie, Sutherland & Ritchie Ltd.	Edmonton
T. W. MEREDITH, *Ex-officio*	Osler, Hammond & Nanton Limited	Calgary

PACIFIC DISTRICT

ROSS WILSON, *Chairman*	A. E. Ames & Co. Limited	Vancouver
A. H. CATER, *Vice-Chairman*	Royal Securities Corporation Limited	Vancouver
H. H. DINGLE	Wood, Gundy & Company Limited	Vancouver
J. H. LAMPREY	Yorkshire Securities Limited	Vancouver
G. H. NATION	Dominion Securities Corporation Limited	Vancouver
H. B. PATERSON	Norman R. Whittall Limited	Vancouver
T. B. READ	Thomas B. Read Company Ltd.	Vancouver
K. G. RUSSELL	McLeod, Young, Weir & Company Limited	Vancouver
J. E. SMART	Pemberton Securities Limited	Vancouver
L. B. WILLIAMS	Hagar Investments Ltd.	Victoria
W. TOM BROWN, *Ex-officio*	Odlum Brown Investments Ltd.	Vancouver

NATIONAL BUSINESS CONDUCT COMMITTEE

ERIC S. MORSE, *Chairman*	W. C. Pitfield & Company, Limited	Montreal
NORMAN J. ALEXANDER	James Richardson & Sons	Winnipeg
E. H. ELY	Wood, Gundy & Company Limited	Toronto
R. H. DEAN	Nesbitt, Thomson and Company, Limited	Montreal
N. H. GUNN	Bell, Gouinlock & Company, Limited	Toronto

DISTRICT BUSINESS CONDUCT COMMITTEES

ATLANTIC DISTRICT

J. W. RITCHIE, *Chairman*	Eastern Securities Company Limited	Halifax
J. A. MACMURRAY	Eastern Securities Company Limited	Saint John
R. C. HEBB	Dominion Securities Corporation Limited	Halifax
F. J. BRENNAN	F. J. Brennan & Company Limited	Saint John
G. W. RAMSAY	Stanbury & Company Limited	Saint John
J. D. WOOD	Nesbitt, Thomson and Company, Limited	Halifax
H. L. GASSARD, *Ex-officio*	The Investment Dealers' Association of Canada	Toronto

QUEBEC DISTRICT

W. M. Reay, *Chairman*	Nesbitt, Thomson and Company, Limited	Montreal
J. Edgar Hill	Royal Securities Corporation Limited	Montreal
R. B. Casgrain	Casgrain & Company Limited	Montreal
Andrew S. Beaubien	L. G. Beaubien & Co. Limited	Montreal
Dudley Dawson	Greenshields Incorporated	Montreal
E. F. C. Kinnear	W. C. Pitfield & Company, Limited	Montreal
H. L. Gassard, *Ex-officio*	The Investment Dealers' Association of Canada	Toronto

ONTARIO DISTRICT

D. S. Beatty, *Chairman*	Burns Bros. & Denton Limited	Toronto
D. Bruce Shaw	A. E. Ames & Co. Limited	Toronto
R. A. Daly, Jr.	R. A. Daly & Company Limited	Toronto
Frank D. Lace	Matthews & Company Limited	Toronto
R. K. Wright	Mills, Spence & Co. Limited	Toronto
M. F. Newman	Cochran, Murray & Co. Limited	Toronto
H. L. Gassard, *Ex-officio*	The Investment Dealers' Association of Canada	Toronto

MID-WESTERN DISTRICT

D. J. Langill, *Chairman*	W. C. Pitfield & Company Limited	Winnipeg
W. S. Dunlop	Oldfield, Kirby & Gardner Limited	Winnipeg
J. D. Bulgin	Dominion Securities Corporation Limited	Winnipeg
Kenneth Rothwell	A. E. Ames & Co. Limited	Winnipeg
Charles McKelvie	James Richardson & Sons	Winnipeg
G. S. Swindell	Wood, Gundy & Company Limited	Winnipeg
H. L. Gassard, *Ex-officio*	The Investment Dealers' Association of Canada	Toronto

ALBERTA DISTRICT

K. M. Johnston, *Chairman*	Wood, Gundy & Company Limited	Calgary
T. W. Meredith	Osler, Hammond & Nanton Limited	Calgary
A. H. Turney	Locke, Gray & Company Limited	Calgary
W. V. Warner	James Richardson & Sons	Edmonton
W. R. Taprell	Carlile & McCarthy Ltd.	Calgary
H. R. Farnsworth	Burns Bros. & Denton Limited	Calgary
H. L. Gassard, *Ex-officio*	The Investment Dealers' Association of Canada	Toronto

PACIFIC DISTRICT

Ross Wilson, *Chairman*	A. E. Ames & Co. Limited	Vancouver
W. T. Brown	Odlum Brown Investments Ltd.	Vancouver
A. G. Osburn	Pemberton Securities Limited	Vancouver
J. M. McAvity	W. C. Pitfield & Company, Limited	Vancouver
J. Denis Hagar	Hagar Investments Ltd.	Victoria
G. D. Sherwood	Thomas B. Read Company Ltd.	Vancouver
H. L. Gassard, *Ex-officio*	The Investment Dealers' Association of Canada	Toronto

DISTRICT ASSOCIATION AUDITORS

Lee & Martin	Maritime Life Bldg.	Halifax, N.S.	3-1311
Peat, Marwick, Mitchell & Co.	901 Victoria Square	Montreal, Que.	UN. 6-2693
Clarkson, Gordon & Co.	15 Wellington St. W.	Toronto, Ont.	EM. 8-2751
Deloitte, Plender, Haskins & Sells	60 Osborne St. N.	Winnipeg, Man.	SP. 4-1601
Peat, Marwick, Mitchell & Co.	508-309 8th Ave. W.	Calgary, Alta.	AM. 6-6041
Buttar & Chiene	789 West Pender St.	Vancouver, B.C.	MU. 3-6964

PAST PRESIDENTS

1916-1917	*William Hanson	Hanson Bros.	Montreal
1917-1918	*A. E. Ames	A. E. Ames & Co. Limited	Toronto
1918-1919	*J. M. Mackie	C. Meredith & Company	Montreal
1919-1920	*Sir Augustus Nanton	Osler, Hammond & Nanton Ltd.	Winnipeg
1920-1921	*J. H. Gundy	Wood, Gundy & Company Limited	Toronto
1921-1922	*R. D. Bell	Greenshields & Co Inc	Montreal
1922-1923	†A. L. Crossin	Oldfield, Kirby & Gardner Limited	Winnipeg
1923-1924	*J. W. Mitchell	Dominion Securities Corporation Ltd.	Toronto
1924-1925	*J. A. Eccles	Harris, Forbes & Company	Montreal
1925-1926	*L. W. Hicks	L. W. Hicks & Company	Winnipeg
1926-1927	R. A. Daly	R. A. Daly Co. Limited	Toronto
1927-1928	*E. G. Hanson	Hanson Bros.	Montreal
1928-1929	*Harry Ford	Osler, Hammond & Nanton Ltd.	Winnipeg
1929-1930	*F. J. Coombs	A. E. Ames & Co. Limited	Toronto
1930-1931	*N. S. Brooke	Royal Securities Corporation Limited	Montreal
1931-1932	*A. H. Williamson	Wood, Gundy & Company Limited	Vancouver
1932-1933	J. G. Weir	McLeod, Young, Weir & Company	Toronto
1933-1934	*W. C. Pitfield	W. C. Pitfield & Company Limited	Montreal
1934-1935	R. W. Gouinlock	Bell, Gouinlock & Co. Limited	Toronto
1935-1936	J. Ernest Savard	Savard, Hodgson & Co. Inc.	Montreal
1936-1937	*R. D. Baker	James Richardson & Sons	Winnipeg
1937-1938	†K. M. Pringle	Dominion Securities Corporation Ltd.	Toronto
1938-1939	D. K. Baldwin	Nesbitt, Thomson & Company Ltd.	Montreal
1939-1940	W. P. Scott	Wood, Gundy & Company Limited	Toronto
June 1940-Nov. 1940	†E. C. Cumberland	Hanson Bros.	Montreal
Nov. 1940-Nov. 1941	*S. B. Hammond	Royal Securities Corporation Ltd.	Montreal
Nov. 1941-1942, June, 1943	H. E. Cochran	Cochran, Murray & Co. Limited	Toronto
1943-1944	W. T. K. Collier	Collier, Norris & Quinlan Limited	Montreal
1944-1945	*A. G. A. Spence	Mills, Spence & Co. Limited	Toronto
1945-1947	A. S. Torrey	W. C. Pitfield & Company Ltd.	Montreal
1947-1948	J. A. Gairdner	Gairdner & Company Limited	Toronto
1948-1949	G. G. Ryan	L. G. Beaubien & Co. Limited	Montreal
1949-1950	†J. B. Ridley	A. E. Ames & Co. Limited	Toronto
1950-1951	Peter Kilburn	Greenshields & Co Inc	Montreal
1951-1952	W. J. Borrie	Pemberton Securities Limited	Vancouver
1952-1953	H. S. Backus	McLeod, Young, Weir & Company Limited	Toronto
1953-1954	Gerard Gingras	René-T. Leclerc, Incorporée	Montreal
1954-1955	N. D. Young	Dominion Securities Corpn. Limited	Toronto
1955-1956	J. R. Hughes	Royal Securities Corporation Limited	Montreal
1956-1957	N. H. Gunn	Bell, Gouinlock & Company, Limited	Toronto
1957-1958	R. H. Dean	Nesbitt, Thomson and Company, Limited	Montreal
1958-1959	E. H. Ely	Wood, Gundy & Company Limited	Toronto
1959-1960	N. J. Alexander	James Richardson & Sons	Winnipeg
1960-1961	Eric S. Morse	W. C. Pitfield & Company Limited	Montreal

*Deceased. †Retired.

The I.D.A.C. - EXHIBIT G

CUMULATIVE RECORD OF COURSE RESULTS

Cumulative Record of New Enrollments from our Members and Passes
(Excluding Readership and Other Enrollments)

COURSE I

Jan. 1948 - June, 1948	Enrolled	315	Completed	262	
Jan. 1949 - June, 1949	"	42	"	33	
Apr. 1950 - Dec., 1950	"	104	"	64	
Jan. 1951 - June, 1951	"	137	"	93	
Sept. 1951 - Mar., 1952	"	137	"	74	
Sept. 1952 - June, 1953	"	292	"	169	
Sept. 1953 - June, 1954	"	222	"	111	
Sept. 1954 - June, 1955	"	278	"	160	
Sept. 1955 - June, 1956	"	426	"	163	
Sept. 1956 - June, 1957	"	413	"	242	
Sept. 1957 - June, 1958	"	495	"	285	
Sept. 1958 - June, 1959	"	301	"	189	
Sept. 1959 - June, 1960	"	439	"	254	
Sept. 1960 - June, 1961	"	266	"	175	2,274
		3,867			

COURSE II

Dec. 1948 - Feb., 1950	Enrolled	361	Completed	159	
Apr. 1950 - Mar., 1951	"	41	"	19	
May 1951 - Apr., 1952	"	113	"	55	
Sept. 1952 - June, 1953	"	167	"	95	
Sept. 1953 - June, 1954	"	159	"	77	
Sept. 1954 - June, 1955	"	148	"	92	
Sept. 1955 - June, 1956	"	190	"	103	
Sept. 1956 - June, 1957	"	183	"	134	
Sept. 1957 - June, 1958	"	166	"	125	
Sept. 1958 - June, 1959	"	218	"	176	
Sept. 1959 - June, 1960	"	175	"	131	
Sept. 1960 - June, 1961	"	208	"	161	1,327
		2,129			
Grand Total Enrollment both Courses		5,996	Grand Total Completed		3,601

Percentage Completions

To June 1961 58.9 %of Course I students and 62.3% of Course II students who enrolled completed the Course. In June 1961, the latest year available, 65.7% of Course I students and 77.4% of Course II students completed.

PART II- The I.D.A.C. - EXHIBIT H

I.D.A.C. Adult Lecture Courses on "Understanding Investment Securities" -
Fall, 1961 to Spring, 1962.
(Each course consisted of between 5 and 15 evening lectures)

Kitsilano High School, Vancouver, B.C.	93
Burnaby Public School, Burnaby, B.C.	17
Vancouver Technical School, Vancouver, B.C.	64
University of British Columbia, Vancouver, B.C.	153
University of Alberta, Edmonton, Alberta	75
University of Alberta, Calgary, Alberta	70
Regina Public School Board, Regina, Saskatchewan	44
University of Manitoba, Winnipeg, Manitoba	148
University of Toronto, Toronto, Ontario	80
Recreation Commission, Village of Forest Hill, Ontario	60
Recreation Commission, Leaside, Ontario	50
Young Men's Canadian Club, Toronto, Ont.	35
Maclean-Hunter Publishing Co. Ltd., Toronto, Ont.	110
Marsh & McLennan Ltd., Toronto, Ont.	50
Y.M.C.A. Adult Education Programme, Hamilton, Ont.	38
St. Catharines Public School Board, St. Catharines, Ont.	25
Ottawa Public School Board, Ottawa, Ont.	50
University of Montreal, Montreal, P.Q.	152
McGill University, Montreal, P.Q.	255
University of Laval, Quebec, P.Q.	72
Bank of Montreal, Montreal, P.Q.	103
Saint Mary's University, St. John, N.B.	60
Total -	1804

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX B

THE FINANCE DEPARTMENT

AND

FEDERAL AND PROVINCIAL GOVERNMENT FINANCING

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

Appendix B

The Finance Department
and
Federal and Provincial Government Financing

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THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

1. We have been invited to present a Brief to the Royal Commission on Banking and Finance. This portion of the Brief covers The Finance Department and Federal and Provincial Government Financing.

2. Within the framework of our particular subject and in accordance with the terms of reference, we will comment on The Finance Department, the investor who provides capital to the Federal and Provincial Governments and those who use it, the dealer who mobilizes capital and those legislative, functional and other influences which set the climate in which the users of capital and financial intermediaries operate. Our comments will be confined to the postwar period for two reasons:

(a) The second World War brought about such great changes in the Canadian debt structure and debt management that any study of conditions as they existed during the War or in the prewar period would have very little bearing on the subject now.

(b) The inflationary tendencies brought about by World War II and continuing through the postwar period have brought about fundamental changes in investor attitudes and decisions.

3. In the early years after the War, as a result of high taxation, increased living costs and continuous inflation, the investor became aware of the advisability of having at least a portion of his money in securities giving him some protection against the continuous erosion in the value of the dollar. At the same time, he became aware that a new era of economic expansion was commencing and wished to share to the utmost in the economic growth of the country. This led the investor to put more of his worth into the shares of Canadian corporations and this tendency has been encouraged by Government policy through the introduction of the "dividend tax credit", which now stands at 20%, as a means of fostering greater development and ownership of Canadian industry by Canadians.

4. The central weakness of the postwar years, insofar as the value of fixed income securities was concerned, was the result of the inflationary forces created during the War. The pent-up demand for all forms of consumer goods and social requirements such as housing, schools, highways, hospitals, etc., coupled with the development of new products and the world demand for our raw materials and semi-finished and finished products created a demand

for labour, materials and capital of unprecedented size. The demand for labour was eased by returning veterans and an aggressive immigration policy. The demand for capital during the postwar period of expansion was satisfied by generation of new money through the buoyancy of the Canadian economy and importation of capital from abroad with an accelerated tendency towards importations of massive amounts during the period 1956 to 1961.

5. In the process institutions, other than banks and the general public, reduced the proportion of Federal Government bonds in their portfolios, not only through committing most newly acquired funds to investment in higher yielding obligations of provinces, municipalities and corporations as well as mortgages, but by selling holdings of Victory Bonds. These Victory Bonds were then retired by the Government through budgetary surpluses or acquired by the banking system where the acquisition resulted in the monetization of the equivalent portion of the national debt to the extent that the increase in the money supply exceeded the development of the economy.

6. During most of the postwar period, the Federal Government, by retaining by agreement or otherwise the main sources of taxation, operated with surpluses and the burden of finding new capital for expansion fell, for the most part, on the provinces, municipalities and private industry.

7. In the same period the Canadian dollar lost approximately 40% of its purchasing value and to this extent, the investor who bought and retained fixed income securities of the Federal or Provincial governments was the loser. On the other hand, the investor who purchased the shares of a cross-section of leading Canadian corporations gained substantially due to the growth in capital value of his share portfolio.

8. As a result, there has been and is now a growing reluctance on the part of many investors to put other than a limited proportion of their funds into long-term bonds and unless inflationary tendencies are checked this proportion is bound to decline.

9. This was the so-called "climate" in which money was raised in Canada and "climate" is still the most powerful single factor in investment decisions at most levels to-day.

The Investor or Provider of Capital

10. There are, of course, important institutional groups in the Canadian economy obliged to buy fixed income securities. Most important among these are insurance companies, banks, trust companies and pension funds, who buy fixed term dollar obligations to offset fixed term dollar liabilities. However, the pension funds to a greater degree than ever before are putting a larger percentage of their investable funds into the shares of Canadian corporations as an offset to the possible further decline of the buying power of the dollar.

11. There is still a segment of the public who buy fixed term obligations of the Federal and Provincial governments, as an adjunct to an equity portfolio for the purpose of providing a liquid reserve of cash with a market value at or near cost. However, for various reasons, there does seem to be a trend away from investment in long-term Government bonds by these private investors and Canada Savings Bonds have been substituted in most of these portfolios to the extent permitted.

12. Many corporations with strong working capital positions have money available for short periods of time. This money, to a great extent, is now being invested in short-term Federal Government securities. A good portion also is invested in other short-term debt instruments, but short-term Federal Government securities, because of their high degree of liquidity, are by far the largest element in this sector.

Fiscal Policies

13. The fiscal policies of the Federal and Provincial governments have a great bearing on the attitude of the investor. In the latter part of the period under review, the Federal Government accepted the principles of deficit financing as a stimulus to a lagging national economy, but recently proper weight does not seem to have been given to the corollary of surpluses and debt retirement in periods of prosperity. What tends to happen is that in periods of surpluses new government spending programmes are initiated in preference to debt retirement. If a proper approach was

taken and it was coupled with a fixed annual sinking fund of 1% per annum on all outstanding Federal Government issues over three years, a greater degree of investor confidence in the security and marketability of the medium and long-term bonds of the Federal Government would be generated. In this connection it is pointed out that most Provinces of Canada now provide sinking fund for both their direct and guaranteed issues as set forth in Exhibit I. The sinking funds on Government of Canada medium and long-term issues need only operate until their terms to maturity are three years or less, since once an issue has less than three years to run, it becomes part of the money market. It is normal policy for the central bank to operate in the money market and to purchase and hold a substantial proportion of the next maturing Government of Canada issue in order to provide for the orderly retirement or refunding of debt. This action will ensure an adequate market for these short-term issues without the need of action by the sinking fund.

Monetary Policy

14. It appears to us that there is a tendency for debt management policy to be unduly subordinated to monetary policy and the Investment Dealers' Association suggests that the Royal Commission inquire as to whether debt management and control of currency have conflicting interests and whether these functions should be separated.

15. If debt management and control of currency were separated and the Department of Finance reassumed the direct responsibility for the management of the national debt, with the exception of money market securities, it would have the effect of bringing the Department of Finance and the Cabinet into closer association with the problems of raising money in the capital markets to implement Government fiscal policies, which do not now adequately seem to reflect the requirements of sound debt management.

16. The Investment Dealers' Association also believes that the Commission should inquire into the Bank of Canada's role in operating the Purchase Fund and trading for Government accounts to determine whether

these functions should be handled by the Department of Finance, or other trading agencies.

(Paragraphs 17 and 18 intentionally deleted)

The Bank Rate

19. Since November 1956, the Bank Rate has been set each week at a level of 1/4 of 1% above the average rate on accepted tenders at the weekly auction of Government of Canada 3-month Treasury Bills.

20. Recently, this method of determining the Bank Rate has been the subject of a good deal of discussion and various views have been expressed. The Investment Dealers' Association feels that there is some merit in returning to the fixed Bank Rate as an instrument signalling important changes in monetary policy. If this were done, there would, of course, be a heavier penalty for chartered banks or money market dealers to using the rediscount privileges of the central bank. As far as the chartered banks are concerned, this would not be too onerous since they seldom use this privilege. However, for the money market dealers the "floating rate" has the advantage of limiting the penalty rate at which the dealers can borrow from the central bank. With a fixed Bank Rate there would be occasions when the cost of day loans would be above the running yield on Treasury Bills. At times when this occurred, dealers would be reluctant to hold large inventories and this in turn could tend to inhibit the size of the money market.

21. It therefore seems appropriate to study the possibilities of returning to an administered Bank Rate, which would clearly indicate the state of the Canadian economy, not only in relation to the internal situation in Canada, but also in relation to other major countries such as Great Britain and the United States. This Bank Rate would be the rate which signals important changes in monetary policy. In addition, and in order to continue to foster the growth of the money market, the money market participants should continue to have the right to sale and repurchase agreements with the Bank of Canada, to the extent of their lines of credit at the average tender for 90-day Bills, plus 1/4 of 1%.

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Overall Government Policy

22. We believe that the Government should pursue appropriate fiscal and monetary policies that have as their basic objective an adequate rate of economic growth which sustains a high level of productivity and employment and reasonable stability of prices. In addition to these objectives we believe the scope and quality of monetary and fiscal measures should be in keeping with the capacity of the Government to finance the national debt without straining its credit resources or impairing the confidence of investors at home and abroad in the integrity of the Canadian dollar and debt obligations of the Government of Canada. To maintain confidence in Government of Canada securities we feel that the authorities responsible for managing national debt should reiterate their belief in the following generally accepted basic principles of responsible debt management -

(a) Government securities must be sound and dependable investments.

(b) Extremes of inflation and deflation should be avoided.

(c) The National debt should be held by as great a number of individuals, institutions and corporations as possible.

(d) Fiscal policy should be directed towards continuous growth in relation to national income.

(e) Periods of budgetary deficits should be offset more equitably by periods of budgetary surpluses.

Comments on the Federal Debt

23. Exhibit II shows the distribution of the Federal debt under four main headings. The Bank of Canada, the chartered banks, Government of Canada accounts, such as unemployment insurance, securities investment and the general public. Exhibit III shows the Total Debt, the Average Term, the Amount of Total Debt Under 3 years, the Percentage of the Total Debt Under 3 years, the Population and the Debt Per Capita as of December 31st, 1946, 1951, 1956 and 1961.

24. During the period marketable debt declined from $16,044,000,000 to $14,575,000,000, but the amount of Canada Savings Loans outstanding increased from $469,000,000 to $4,079,000,000. Thus we are now in a position where out of a total debt of $18,599,000,000, only $8,362,000,000

or 45% is for a fixed period of over 3 years; $6,158,000,000 or 33% matures in under 3 years and a further $4,079,000,000 or 22% consists of Canada Savings Bonds which represent a call on the Government for cash at any time.

Marketing of New Issues and Investor Attitudes

25. In the last five years large Federal Government deficits have necessitated substantial annual increases in the debt. The marketing of the issues to cover the deficits was made possible to a large extent through the development of the money market. The one attribute which Federal securities should have which is not possessed in the same measure by any other security is their market liquidity. With the concentration by the Federal Government on the mass public market for new funds through the medium of Canada Savings Bonds, this liquidity, or ease of marketability, for fixed term securities has declined in recent years for all but the shorter maturities. This has meant that those financial institutions such as chartered banks, trust companies for their guaranteed investment account and corporations have tended to confine their investments to Government bonds of shorter maturity. In situations where an investor has chosen to buy longer term bonds the tendency has been towards the purchase of provincial, municipal or corporation bonds where a higher yield has been available with ample security and in many cases as satisfactory a degree of marketability due to the operation of sinking funds in the case of provincial and corporate securities.

Canada Savings Loans

26. Since their introduction in 1946, Canada Savings Bonds have become a significant element both in the debt structure and in the annual public borrowing operations of the Federal Government. Despite sizable redemptions for cash over the years, the outstanding amount of Savings Bonds has increased year by year since 1951 to nearly $4.1 billion, and is now equal to just under one-quarter of the public debt. To the end of December, applications for the 1961 Series, first offered in October, numbered in excess of 1 1/4 million for over $932 million of Bonds.

27. Savings Bonds are designed for individual investors of modest means but have been bought, within the limitations established for each issue, by larger investors. Being the equivalent of cash, they are the most suitable and have become the most acceptable form of risk-free investment for persons who are unable or unwilling to assume the risks of the price declines which can occur in market type securities. For these reasons, it seems certain that the kind of personal savings mobilized for Government use by the issue of Savings Bonds is, to some extent, a body of funds which would not be invested in other forms of securities if Savings Bonds were not available each year for public purchase.

28. While the prime reason for the annual sale of Savings Bonds is to provide part of the cash required to finance Government expenditures, they also serve other important purposes. For example, they encourage the ownership of liquid assets by a large number of families which might not otherwise be inclined to save. Then, by increasing greatly the number of persons who have some direct ownership of securities, the Savings Bond programme over the years has undoubtedly widened public interest in securities.

29. Benefits and advantages of Savings Bonds to the individual investor and to the Canadian economy are costly to the issuer. From available evidence, it is certain they are costly to sell and to service because cash redemptions well before final maturity date constitute a high proportion of original sales. (See Exhibit 4). This means a large part of the funds realized from the sale of each Series is available to Government use for only a relatively short period. Then, because they confer the right of cash redemption, Savings Bonds are, in effect, demand obligations which currently aggregate the sizable magnitude of over $4 billion. Through control of the money supply, the Federal Government can always pay its debts. But, increasing the money supply to finance debt retirement is not always a sound course of action. For this reason, there could be times when Government borrowing operations to raise funds for Savings Bond redemptions would impose undesirable burdens on the capital market.

30. From this brief outline, it is evident that the economic dangers and financial costs inherent to Savings Bonds impose a limitation on their use as an instrument of debt management policy. Their advantages can be purchased at too high a price. Moreover, their use by borrowers other than the Federal Government involves even greater risks.

31. The great difficulty lies in fiscal policy. Had fiscal policy not led to large deficits in the last few years, it is possible that Savings Loans, as a major money raising vehicle, would not have been used to the same extent. The solution to the problem lies in smaller deficits on the part of the Federal Government and less reliance on Savings Loans with a greater emphasis on fixed term securities as a means of raising governmental requirements.

Recommendation

32. We recommend that Canada Savings Loan issues in the future be offered as a pure savings instrument and that the maximum amount available to any one buyer be examined. Originally, Canada Savings Loan issues were made with the idea of educating the small buyer to the theories of thrift, but recently, there has been a tendency to use this method of financing as a major money raising vehicle. The general consensus of opinion of the members of the Investment Dealers' Association is that the maximum amount to any one buyer should not exceed $5,000 and that the selling emphasis should be in the area of the payroll savings for the small investor. If this approach was taken it would, of course, be necessary, if the demand for new money persists, to raise the greater percentage of the Government's requirements through the medium of issues with a fixed maturity.

Federal and Provincial Financing in the Last Ten Years Under Review

33. As we entered the 1950s, it was obvious that the investor climate had shifted for reasons outlined in the previous paragraphs and it was therefore no longer possible for the Government to continue to borrow the appro priate portion of its requirements in the long-term sector. It was in this period that the Conversion Loan of 1958 was conceived as a refunding operation to lengthen the overall maturity of the debt. The provinces, with credit only second to the Government of Canada, could always offer their issues to give a higher yield and the public was demanding a portion of its investment in shares to offset the inflationary tendencies of the economy.

34. It was therefore necessary for the Government to tap other sources for their new money requirements. These sources were demanding shorter-term securities with a high degree of liquidity. In line with this demand the Government encouraged the development of the money market at the same time that investor psychology was changing. This enabled the Government to raise its necessary requirements in the short-term area and left the long-term market, except for C.N.R. financing, free for the provinces, and other long-term borrowers. Most provincial borrowing is for long-term projects and long-term debt should be issues against these projects. In some instances, the provinces have used the short-term market for fixed term securities and savings loans and other routes. This method of provincial financing, particularly in the case of provincial savings loans should be limited, as the provinces are not in control of currency and credit.

35. It appears to us that it is not vital to have the average term of the Federal debt extended to its absolutely attainable length. However, having in mind that Federal borrowing is not only to finance deficits and refund maturing obligations, but to provide funds for government agencies who normally require long-term debt, such as the Canadian National Railway, St. Lawrence Seaway, housing, etc., it is only sound practice that our Federal debt should be for a somewhat longer period than its counterpart in the United States where Government agencies also borrow for their own account. In the United States the average term of the marketable debt was 4 years and 7 months as of December 31st, 1961 and the comparable figure for Canada was 8 years and 4 months.

36. There will be periods in the future as in the past when depressed conditions in Canada indicate that the money supply can be increased without inflationary implications. This is a time when a greater proportion than otherwise of the investment dollar flows into debt securities. It is in such times that long-term debt can be issued or major conversion opportunities arise for a lengthening of the average term of the Federal debt.

RECOMMENDATIONS

37. 1. In times of high business activity, governments should budget for surpluses which should be used to retire debt and not for the development of new government spending programmes. Sinking funds on long-term Federal issues, such as exists on provincial debt, would materially assist orderly marketing.

38. 2. Every effort should be made to reduce the Government's reliance on Savings Loan issues as a major money raising vehicle.

39. 3. Because of the nature of provincial requirements, provinces should only resort to short-term Fixed Maturity debt instruments when long-term money is not available.

40. 4. Since the provinces are not in control of currency and credit the use of Savings Loan type of issues should be sharply curtailed.

41. For comparative purposes and in order that a proper assessment of our own methods of financing of the Federal and provincial governments in Canada may be made, it seems appropriate to review the methods employed in the United Kingdom and the United States and draw some conclusions.

Comparison Between Canada and the United Kingdom

42. During the period under review, 1946 to 1961, the market in the United Kingdom for British Government and local authority issues (the latter being the equivalent of our provincial issues) has exerted very little influence on the level of the Canadian high-grade market. In our opinion, therefore, it is unnecessary to make an exhaustive comparison of the two markets, except to comment on the different methods employed in the two markets to raise capital for similar types of issues.

43. In Britain the Bank of England controls the terms and time of issue in the categories under review. There are three main categories used in Britain as follows:

1. Treasury Bills

44. As in Canada, Treasury Bills in Britain come up for tender once a week. Unlike Canada, the British banks do not tender for Bills for their own account, but meet their requirements by purchasing Bills from the discount market, which is comprised of a group of discount houses, nominated by the Bank of England, which are members of the London Discount Market Association, and each week these members put in one composite bid for the entire tender. The British banks and others then purchase their requirements from the discount houses at the then market level.

2. British Government

45. British Government issues are made through the Bank of England which pays a commission to banks and dealers for orders received and accepted. If the issue is not entirely subscribed for in this manner, the issue is announced as having been fully subscribed, the balance being underwritten by the Issue Department of the Bank of England and gradually sold into the market at the going rate by the Government dealer, and the price at which the security is eventually sold is therefore, in effect, the issue price.

3. Local Authorities

46. Local authorities, which are in effect the equivalent of our provincial issues, usually employ a dealer to advise them on the terms and conditions of the issue for a fee, usually 1/4 of 1%. In the first instance an issue is fully underwritten by a group consisting of all types of financial institutions. The underwriting group receives a fee of from 3/4% to 1%, depending on whether the operation is a conversion offer or to raise new money. In addition to the above charges a commission (allowance) of 1/4 of 1% is paid to banks and dealers on allotments made in

respect of their applications. Thus the total costs in this respect are between 1 1/4% and 1 1/2%. The issues are made by public subscription with advertisement in the press inviting applications. If the issue is fully or over-subscribed by such public subscriptions, the underwriting institutions mentioned receive no allotment in respect of their underwriting. Thus if they wish to subscribe to the issue they have to make application along with the rest of the investing public. If the issue is not fully subscribed the underwriters receive their proportion of the unsubscribed amount which is either retained as a permanent investment or sold in the market at the going quotation.

RECOMMENDATIONS

47.

1. The method employed in Canada for Treasury Bill financing seems more suitable than the method employed in the United Kingdom for this market. The "one bid" method employed in Britain is suited to the special conditions of that market and is not strictly comparable with the method of operation in Canada.

48.

2. Direct British Government financing is carried on in much the same manner as in Canada except that in Canada it has been the practice of the Bank of Canada, acting as agents for the Government, to give dealers a firm amount of bonds on announcement of the new issue in order that confirmation can be given to the dealers' customers. We feel that the system employed in Canada is more appropriate for our market in that it allows immediate confirmation to the customer and gives dealers the ability to accurately appraise the demand when they subscribe for additional bonds.

49.

3. The financing of local authorities is similar to the way our provinces are financed in Canada insofar as they are done through a dealer manager, but at this stage the similarity stops. All the manager does is set the issue

Recommendations (continued)

up for a fee and then orders may flow in direct to the local authority and allotments are made.

50.

4. In the case of Canadian provincial issues, the most accepted and, in our opinion, the best method is to appoint a manager, who forms a strong group of underwriters. After consultation with the borrower and the senior members of the underwriting group, a bid for all or part of the issue is made to the province concerned. It is then the responsibility of the dealer group to merchandise the securities in which it has a definite liability. The fact that the group has a liability makes it essential that it distributes the securities as quickly as possible and also develops for the province concerned the most widespread and steady market for its issue.

Comparison Between Canada and the United States

51. Because of the importance which the United States Government bond market exerts on the Canadian Government bond market, a more thorough review seems to be in order. Basically, the interest rates in the United States and in Canada bear a definite relationship and since we in Canada operate in the dollar area, there is a substantial flow of capital between the two countries. This flow has the effect of arbitrage and tends to keep what is regarded as a proper yield spread between the two markets, taking into account the yield obtainable in the comparable credits of the two markets and the level of our dollar in relation to the United States dollar. The essential difference between Canada and the United States in the distribution of direct Federal government securities lies in the lack of any compensation in the United States to dealers and dealer banks through whom the issues eventually reach the investor.

52. In a country such as the United States which has reached the stage in its development where it is creating savings at a greater rate than they can be employed, this system can perhaps be justified. It

does, however, mean that Government issues handled in this way do not find their way into the broad public market. There is therefore no public market such as we have in Canada for Government securities. So United States Government debt securities tend to be held in the main by Government accounts, banks, insurance companies, trust companies, pension funds and other semi-institutional pools of investment capital. This is accounted for by the tax exempt United States State bonds being available to private investors in the United States and not in Canada.

Government Treasury Bill Market

53. The Government Treasury Bill market is handled much the same as in Canada. These Bills are sold at auction once a week. A group of seventeen accredited dealers and banks, which have been recognized as purchasers by the Open Market Committee, bid on the Bills, and market them in a similar way to that which is employed in Canada.

54. In the United States the equivalent of the provincial issues are the State issues. The method of marketing is similar in some ways to the Canadian method in that new issues are either sold by public tender to a group of dealers of whom one is the manager, or the manager of a group negotiates the price and terms on behalf of his group. The marketing then takes place in a similar way to that which is employed in Canada.

55. All State issues in the United States are exempt from all Federal income taxes and the obligations of any State are exempt from any State income taxes levied by that State. As a result of the tax exempt feature on State issues, the yield is relatively low and the demand comes, not from the broad general public, but from wealthy individuals and companies where the tax feature has an important bearing. This precludes any broad public distribution in the sense that we understand it in Canada.

(Paragraph 56 deleted intentionally)

RECOMMENDATIONS

57.
1. No recommendations seem necessary as far as the method of handling Treasury Bills in our market is concerned. It is pointed out, however, that in the United States, the seventeen accredited dealers and banks are the only bidders, whereas in Canada any dealer can make a bid at the auction. Although in practice only the dealers nominated to the money market make a bid.

58.
2. The method used by the United States Federal Government to raise money would not, in our opinion, do the job in Canada. The fact that the United States government pay no concession for distribution means that their distribution is limited as pointed out in previous paragraphs. The one thing which is required in Canada is widespread public distribution and this can only be secured by paying the dealers a compensation for distribution.

59.
3. In view of the fact that United States State bonds are exempt from Federal Taxation and also exempt from any State income taxes levied by that State, it is difficult to derive any definite conclusions between the two markets.

Marketing of New Issues

60. We have discussed marketing procedures in Great Britain and the United States. The following paragraphs will be devoted to the marketing of new Government of Canada and provincial issues in Canada.

Government of Canada Issues

61. The timing and terms of Government of Canada issues are determined by the Finance Department on advice from its agent, the Bank of Canada. The amount required in any one year is determined by the amount of maturing obligations in that year, plus the new money requirements, if any. During the first ten years under review, the Federal Government enjoyed surpluses, with the exception of 1946 and 1955, and their outstanding unmatured debt decreased from $17,313,000,000 in 1946 to $15,334,000,000 in 1951 and $15,234,000,000 in 1956. The marketing, therefore, of new issues was almost entirely confined to refunding and did not present a problem of any great magnitude. However, in the last five years, with one exception, the Federal Government has experienced large deficits, with the result that the problem of new public issues has been considerably expanded as witnessed by the increases in the Federal debt to $18,599,000,000 as at December 31st, 1961.

62. Various techniques have been evolved through experience. Recently new issues have been confined to the short-term area which has allowed other borrowers, such as the provinces, to enjoy as much freedom as possible in the long-term market. All Government issues have been marketed through normal dealer channels and with some exceptions firm participations have been given to dealers for distribution to their customers.

63. There has been some criticism that the list of primary distributors now in use by the Bank of Canada is outmoded and that many so-called prime distributors are, in fact, not normally engaged in the distribution of Government securities and it is recommended that the list of primary distributors be thoroughly overhauled in order that the best possible public distribution be secured for the Government under present conditions. Another point which deserves study is the recent trend

towards new issues by the Government, being taken up entirely by the Bank of Canada and then marketed at a later date. Between the time these issues are announced and the time they are available in the market, the dealer must make an educated guess on what the price will be and hope to provide fair value to the investor. This does not induce proper widespread distribution and does foster a certain amount of speculation which is undesirable, particularly in the securities of the Government of Canada.

64. The price of the issue, which is entirely taken up by the Bank of Canada and marketed in the manner outlined above, is publicly announced. The price at which the issue is traded one week later inevitably is either above or below the announced issue price with all the market repercussions which this sort of an operation creates. In addition, the issue price may be too high and subsequent demand therefore so limited that a very small percentage is held by the public with a consequent thin after-market.

RECOMMENDATIONS ON GOVERNMENT FINANCING

65. In order that the experience and technical marketing skills and knowledge of the investment industry, which is in close and daily touch with the ultimate buyer of Government of Canada securities, be effectively centralized and made available to the debt managers, it is recommended that a standing committee on the marketing of Government of Canada Bonds be established by government decree. This committee would act in an advisory capacity to the Bank of Canada and the Department of Finance in connection with the marketing of Government of Canada issues and problems arising therefrom or related thereto. It should be comprised of men of experience and independent judgment in the field of Government finance drawn from the investment industry and, if deemed necessary, from other segments of the financial community. The Committee should be workable in size to facilitate decision-making and ease of consultation in Ottawa when requested by the Bank of

Canada and/or the Department of Finance. Its composition should recognize the geographical location of the various financial centres of Canada with appropriate weight being given to their size and importance.

RECOMMENDATIONS ON C.N.R. FINANCING

66. As a result of the success of provincial financing through large national syndicates it is recommended that future Canadian National Railway or other Government agencies which require long-term financing, should be handled in a similar way to that of the financing of the larger provinces. That is, a large national syndicate should be formed headed by a dealer or group of dealers to be chosen by the Department of Finance in consultation with the C.N.R. and the Bank of Canada. In fact, there was in existence a strong national syndicate which handled all C. N. R. financing until such financing came under the direction of the Bank of Canada. The manager, or managers, would then form a banking group composed of the dealers in Canada, who usually underwrite and take a liability and who would be available for prior consultation on timing, size, maturities and prices of new issues to be brought to the market. In addition to this, there should be a selling group of all other distributors of Government securites in Canada. There will inevitably be some dealers who are designated as selling group members, who will feel they should be members of the banking group. Their proven distributing power would be the deciding factor as to whether they are members of the banking group or the selling group, and this should be decided in consultation with the C.N.R., the Finance Department, the Bank of Canada and the management group.

Provincial Financing

67. As we entered the 1950s, it was obvious that the investor climate had shifted for reasons outlined in the opening paragraphs of this Brief and it was at this time that the requirements of the provinces were becoming very large as a result of huge expenditures which had to be made for hospitals, roads, schools, public utilities, etc.

68. It was in this period that the Bank of Canada, with the assistance of the chartered banks and money market dealers, formed the money market, which developed a far broader and deeper market for Federal Government Treasury Bills and Federal Government market issues maturing in less than three years and this enabled the Federal Government to raise the major portion of its requirements in this area leaving the longer term markets available to the provinces, which due to the nature of their requirements should, under most circumstances, borrow their requirements in the long-term market.

69. Since there are not enough large pools of money in Canada to finance the requirements of the provincial governments, it has become increasingly evident that broad public distribution is the only way in which the provinces could raise their requirements. It is apparent that these large requirements can only be raised through the medium of continuing strong national syndicates, with the exception of provinces whose requirements are not large.

70. The issues are usually negotiated by the syndicate manager, who has the benefit of advice from what is known as a steering committee. This committee is made up of qualified persons from members of the syndicate whose judgment have been time proven. Once the price and terms have been settled the syndicate, which is handling the issue, takes a liability. This liability is the driving force behind the dealer fraternity to distribute the securities to the public and is one of the reasons why there is such a broad, healthy interest in provincial issues. The syndicate also has a further responsibility of continuing to foster the market for provincial securities between new

issues and keep the provinces informed of market conditions. We cannot stress too strongly the fact that provincial borrowing is for long-term projects and long-term debt should be issued against these projects. In some instances, the provinces have used the short-term market for dated securities and savings loans and other routes. This method of provincial financing, particularly in the case of provincial savings loans, should be limited as the provinces are not in control of currency and credit.

Method of Distributing Provincial Securities to the Public

71. Whether the distribution of provincial securities to the public is made through a single dealer or a syndicate composed of a number of dealers, the process is the same. The issue is either purchased by public tender or the purchase is at a negotiated price. Once this has taken place the issue is set up to offer to the public. The retail price is set, concessions to sub-agents and dealers announced to the trade, and a decision is reached as to whether there will be a selling group or not. The decision to have a selling group is governed by the size of the issue. On relatively small issues, widespread distribution is not required and, therefore, there would not normally be a selling group, but on larger issues, there usually is a selling group and this group is usually composed of members of the I. D. A. who are not the original buyers of the issue or who are not in the syndicate who purchase the issue.

72. The terms are set and usually 50% to 60% of the issue is confirmed to the underwriting group for sale to their clients. The remainder is reserved for the exempt institutions and selling group. Exempt institutions are made up of all the large insurance companies, trust companies and banks. The amount of bonds purchased by the exempt institutions varies very widely depending on the amount of money they have available for investment at the time. The amount of bonds confirmed to the selling group varies to some extent depending on the size of the

issue, with the selling group usually receiving a larger percentage of the amount on large issues. In small issues adequate allotments to the selling group present a problem for the 189 members of the I. D. A.

73. If exempt institutions and the selling group do not subscribe for the amount set aside for them it is obviously the liability of the originating group to absorb this amount into their own book and do the distribution themselves. If the selling group dealers subscribe for more than is normally available to them the originating syndicate tries to make a further amount available out of their own firm bonds or perhaps take a short position not only for after-market operations but in order that selling group members get as fair treatment as possible under the market conditions then existing.

RECOMMENDATIONS

74\.
1. Due to the nature of provincial requirements, provinces should only resort to short-term fixed maturity debt instruments when long-term money is not available.

75\.
2. Since the provinces are not in control of currency and credit, the use of savings loan types of issues should be sharply curtailed.

76\.
3. We recommend that provincial financing, except for small issues should be handled by large national syndicates headed by the managing firm, which in turn should be backed up by a steering committee composed of qualified persons from members of the syndicate. It is in this way that a continuous broad, healthy market will be maintained for provincial securities in Canada.

SUMMARY OF RECOMMENDATIONS

REFERENCES

The Association recommends:

REFERENCES	
Pr. 13 Pages 3 to 4	(a) that Government of Canada issues with maturities in excess of three years should have an annual sinking fund of 1% of their principal amount;
Pr. 14 Page 4	(b) that the Commission enquire as to whether debt management and control of currency have conflicting interests and whether these should be separated.
Pr. 16 Page 4	(c) that the Commission should enquire into whether Bank of Canada or some other agency should operate the purchase fund and government accounts.
Pr. 19 Page 5 to Pr. 21 Page 6	(d) that consideration be given to establishing two separate bank rates as follows: (i) a rediscount rate for chartered banks and money market dealers established on the basis as the present so-called "floating rate", and (ii) a fixed Bank Rate to signal important changes in monetary policy and consequently the prime lending rate of Chartered Banks;
Pr. 22 Page 7	(e) that the Government reiterate its belief in the generally accepted basic principals of responsible debt management;
Pr. 26 Page 8 to Pr. 32 Page 10	(f) that serious consideration be given to changing the 1962 fall Savings Loan Campaign by combining a smaller Canada Savings Loan issue with a fixed term issue;

(g) (i) that the Government should budget for surpluses in periods of high business activity for the purpose of debt retirement;

Pr. 33 Page 10 to Pr. 40 Page 12

(ii) that the Government rely less on Canada Savings Bonds as a major vehicle for raising money;

(iii) that Provincial Governments sharply curtail the use of Savings Loans type of issues as a money-raising vehicle and only use short-term fixed debt instruments for such purposes when long-term money is not available;

(h) that the present methods employed in Canada for Treasury Bill financing, the direct placement of Government of Canada issues and the underwriting of Provincial issues be continued in preference to the methods used in the United Kingdom for comparable issues in that market;

Pr. 42 Page 12 to Pr. 50 Page 15

(i) that the present methods employed in Canada for Treasury Bill financing, the direct placement of Government of Canada issues and the underwriting of Provincial issues, while similar in many respects to United States practises, be continued in preference to the methods used in the United States for comparable issues in that market;

Pr. 51 Page 15 to Pr. 59 Page 17

(j) that a standing committee on the marketing of Government of Canada Bonds, to comprise men from the financial community having experience and independent judgement in the marketing of Government of Canada Bonds, be established by

Pr. 61 Page 18 to Pr. 65 Page 19

Government decree to act in an advisory capacity to the Bank of Canada and the Department of Finance in connection with the marketing of Government of Canada issues;

Pr. 66 Page 20

(k) that future financing of the Canadian National Railways, and other Government agencies requiring long-term financing, be arranged through large national syndicates of investment dealers managed by one or more dealers selected by the Department of Finance in consultation with the Canadian National Railways and the Bank of Canada;

Pr. 67 Page 21
to
Pr. 76 Page 23

(l) that Provincial financing, except small issues, should continue to be arranged through large national syndicates of investment dealers managed by one or more dealers backed up by a steering committee composed of qualified persons sslected from members of the syndicate.

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EXHIBIT I

Issue	Sinking Fund
Province of Alberta Municipal Financing Corporation	2% of the principal amount annually.
Province of Manitoba	1% to 3% of the principal amount annually.
Manitoba Hydro-Electric Board	1% of the principal amount annually plus 4% on balances in the Sinking Fund Account.
Province of New Brunswick	2% to 3% of the principal amount annually.
Province of Newfoundland	1 3/4% to 3% of the principal amount annually.
Province of Nova Scotia	3% of the principal amount annually.
Province of Ontario	Appropriations made annually to a general sinking fund. Several issues have specified sinking fund arrangements.
Hydro-Electric Power Commission of Ontario	Annuity method, using a 4% interest rate, applied to value of operating properties which are written off over 40 years.
Province of Prince Edward Island	3% of the principal amount annually.
Province of Saskatchewan	3% of the principal amount annually.
Province of Quebec	1% of the principal amount annually.
Quebec Hydro-Electric Commission	1% of the principal amount annually with respect to shorter maturities and 2% of the principal amount annually with respect to longer maturities.

EXHIBIT 11

DISTRIBUTION OF GOVERNMENT OF CANADA SECURITIES

As at December 31st

(in millions of par value)

Year	Total Debt	Bank of Canada	As % of Total Debt	Chartered Banks	As % of Total Debt	Govt. of Canada Accounts	As % of Total Debt	General Public Holdings Market*	General Public Holdings Non-Market**	General Public Holdings Total	As % of Total Debt
1946	17,313	1,904	11.00%	3,317	19.16%	918	5.30%	9,937	1,237	11,174	64.54%
1951	15,334	2,222	14.49	2,830	18.46	1,009	6.58	8,079	1,194	9,273	60.47
1956	15,234	2,426	15.92	2,524	16.57	1,518	9.96	6,225	2,541	8,766	57.55
1961/	18,599	2,856	15.35	3,786	20.36	658	3.54	7,221	4,079	11,300	60.75

* This denotes the amount of the Federal Government debt held by the General Public exclusive of Savings Loan Bonds.

** This denotes the amount of Savings Loan Bonds held by the General Public.

/ As at January 2, 1962 from figures supplied by the Bank of Canada.

Source: Bank of Canada "Statistical Summary Supplement 1960" Government of Canada Direct and Guaranteed Securities Distribution of Holdings.

February 14, 1962.

Exhibit 111

DISTRIBUTION OF GOVERNMENT OF CANADA SECURITIES

Year	Total Debt*	Average Term (excl. Savings & Perpetuals**) Years & Months	Under 3 Years*	Under 3 Years as % of Total Debt	Population	Debt Per Capita***
1946	$ 17,313	9 - 11	$ 3,211	18.55%	12,292,000	$ 1,408.48
1951	15,334	7 - 6	3,691	24.07	14,009,429	1,095.12
1956	15,234	6 - 7	4,727	31.03	16,080,791	947.34
1961	18,599	8 - 4	6,158	33.11	18,400,000	1,010.82

* In millions

** Savings Loan Bonds and Perpetuals have been excluded in arriving at the average term due to the fact that Savings Loan Bonds may be cashed at any time at the holder's option and the Perpetuals have no fixed maturity.

*** The debt per capita represents all outstanding debt.

Source: Bank of Canada "Statistical Summary Supplement 1960", Bank of Canada Statements and from figures supplied by the Bank of Canada.

February 14, 1962.

EXHIBIT IV (a)

CANADA SAVINGS BONDS

It has been assumed that the amount of each issue outstanding at January 1st represents the total sales of such issue. The January 1st figure represents on the average approximately 90% of total sales.

Total Sales (1946 Series 1 to 1961 Series 16)	$10,408,715,000
Total Amount Outstanding as at January 1, 1962	4,079,000,000
Amount of Redemption and Maturities	$ 6,329,715,000
Total amount of issues maturing during period (1947-1961)	$ 1,503,172,000
Resulting amount of Redemption during period (1947-1961)	$ 4,826,543,000

Redemption as a percentage of Total Sales...	46.4%
Maturing issues as a percentage of the Total Sales...	14.4%
Total Amount at January 1, 1962 as a percentage of Total Sales...	39.2%
	100.0%

February 14, 1962.

EXHIBIT IV (b)

CANADA SAVINGS BONDS

ANNUAL AMOUNTS OUTSTANDING
AS OF JANUARY 1st

(Thousands of Dollars)

Year	Series 1 (1946)	Series 2 (1947)	Series 3 (1948)	Series 4 (1949)	Series 5 (1950)	Series 6 (1951)	Series 7 (1952)	Series 8 (1953)	Series 9 (1954)
1947	$469,251	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
1948	416,963	256,014	-	-	-	-	-	-	-
1949	338,296	201,795	230,929	-	-	-	-	-	-
1950	292,237	160,893	176,205	282,856	-	-	-	-	-
1951	252,296	135,634	133,027	214,182	264,122	-	-	-	-
1952	206,361	109,731	104,719	153,970	166,551	351,474	-	-	-
1953	175,371	92,901	87,385	126,799	118,738	265,610	331,986	-	-
1954	99,784	52,905	48,642	71,208	66,708	173,342	219,516	840,633	-
1955	72,717	38,641	35,756	52,603	48,928	152,747	173,354	722,874	792,356
1956	58,306	31,142	28,682	42,357	39,049	139,537	154,913	647,549	628,363
1957	-	22,937	21,075	31,449	28,752	120,783	137,708	579,720	369,189
1958	-	-	14,768	22,326	20,399	82,481	97,185	386,510	203,364
1959	-	-	-	17,227	15,695	62,348	75,035	294,456	147,279
1960	-	-	-	-	11,277	37,662	41,667	148,566	86,929
1961	-	-	-	-	-	30,663	33,042	115,850	68,725
1962	-	-	-	-	-				

Year	Series 10 (1955)	Series 11 (1956)	Series 12 (1957)	Series 13 (1958)	Series 14 (1959)	Series 15 (1960)	Series 16 (1961)	Total	Net Dollar Increase	Total Sales Of Issue *
1947	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 469,251	$469,251	$ 535,285,550
1948	-	-	-	-	-	-	-	672,977	203,726	287,733,100
1949	-	-	-	-	-	-	-	771,020	88,043	260,491,150
1950	-	-	-	-	-	-	-	912,191	141,171	320,200,000
1951	-	-	-	-	-	-	-	999,261	87,070	285,600,000
1952	-	-	-	-	-	-	-	1,092,606	93,345	394,642,400
1953	-	-	-	-	-	-	-	1,198,790	106,184	380,761,100
1954	-	-	-	-	-	-	-	1,572,738	373,948	850,548,900
1955	-	-	-	-	-	-	-	2,089,976	517,238	800,540,900
1956	649,824	-	-	-	-	-	-	2,419,722	329,746	729,100,000
1957	404,225	792,441	-	-	-	-	-	2,508,279	88,557	853,810,150
1958	208,935	395,534	1,164,766	-	-	-	-	2,596,268	87,989	1,216,711,900
1959	148,945	273,702	1,017,608	835,199	-	-	-	2,887,294	291,026	923,697,450
1960	85,423	145,868	792,967	454,283	1,398,794	-	-	3,203,436	316,142	1,536,050,600
1961	67,135	114,642	720,467	348,825	1,271,407	815,724	-	3,586,480	383,044	960,462,000
1962							932,346	4,079,000	492,520	

* Figures are for entire loans, either to the closing date within the year or in the subsequent year.

Source: Bank of Canada Loans of Government of Canada and loans Guaranteed by The Government of Canada 1947 - 1961.
Canada Year Book, 1961.

February 1962.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX C

BANK OF CANADA

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX C

BANK OF CANADA

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I. ORIGINAL CONCEPTIONS OF THE BANK OF CANADA

1. The previous Royal Commission in Canada, comparable to the one now sitting was the Royal Commission on Banking and Currency in Canada, which, under the Chairmanship of Lord Macmillan, held hearings and made its Report in 1933. It is appropriate to review briefly the scope of its findings which were principally related to:

i. The provisions of the Bank Act, in the light of the forthcoming 1934 revision.

ii. The facilities provided by the Finance Act of 1923.

iii. The advisability (or otherwise) of establishing a central bank with special reference to such a bank's relationship with existing commercial banks, its authority and its functions.

2. The Report related how the Canadian banking system had evolved over a long period of years in such a manner as to suit the peculiar needs of the country. However, with the changes in the economy that had taken place since the Great War, the system was not as satisfactory, relatively, as it had been. Some of these changes included the extensive need for foreign borrowing to finance the country's development, difficulties of making payment of both principal and interest on such debt, and some degree of economic instability caused by the greater dependence of Canada upon world economic conditions and prices resulting from an increasing volume of both exports and imports.

3. Internally, there was also a certain lack of flexibility under the terms of the Finance Act, which permitted the banks to obtain advances from the Treasury Board against suitable collateral.(1) Advances were frequent, since they were an important means of the banks maintaining adequate cash ratios in the face of seasonal variations in economic activity and loan demand. Another method was the use of the New York money market where "secondary" reserves could be employed profitably.

(1) Rates, terms, amounts and margins on such advances were determined by the Board which was comprised of the Minister of Finance and several Cabinet Ministers and was, thus, purely political. The rate at the time of the hearings was 2½%, which became the initial level of the Bank of Canada's discount rate.

4. There was no single banking authority which was detached from commercial banking and yet linked to national business which could endeavour to:

   i. Maintain stability in the currency and price level.
   ii. Regulate the quantity and flow of credit, seasonal or otherwise.
   iii. Regulate exchange fluctuations arising from trade and capital flows.
   iv. Co-operate in international monetary affairs with other governments and central banks.
   v. Provide impartial and sound advice on internal fiscal policy.

5. Experience in other countries indicated that a central bank could perform all of these functions. Indeed, since it appeared that no other body could do so, the Commission (by a majority) recommended the establishment of such a bank.

6. The Commission felt that the Bank should be free from political interference[1] and, as such, should not be a direct organ of the government. However, the government should have some control over the appointment of the senior officers and directors, all of whom should have experience, skill and integrity in order that the bank could gain the confidence of the Government, the public, the "commercial" banks and its counterparts abroad. The feeling was that the share capital should be subscribed by the general public, with dividends limited to a nominal amount, and any other profits accruing to the government. Other recommendations provided that the new Bank should:

   i. Have the sole right of note issue.
   ii. Be banker to the Dominion government.
   iii. Hold deposits of each of the commercial banks.[2]
   iv. Buy and sell exchange and specified securities, as well as discounting the latter.
   v. Issue and manage the public debt of the government.

On this last function, comments were so limited that one may conclude that the Commission had not visualized the future magnitude of the job and the obvious conflict of interest with monetary policy which was later to materialize. On the other hand, the Report went to considerable length in describing the central bank's other functions, such as exchange dealing and monetary policy, its effects upon the

(1) Macmillan Report - paragraph 219. See Exhibit 1.

(2) The suggested rate was 5% of each bank's deposit liabilities. This was incorporated in amendments to the Bank Act in 1934.

level of economic activity, ways and means by which commercial banks' reserves could be changed, etc. The Commission expressed the view that in Canada, despite the absence of a money market, the banking system would be sufficiently sensitive to changes in the discount rate, open-market and foreign exchange operations, for the central bank to be able to initiate or counteract trends as circumstances required. The Report also pointed out that central bank control over exchange rates was desirable, since fluctuations were often the outcome of credit conditions which could cause short term capital movements, extensive foreign borrowing or lending, and because internal price levels, to the extent they were influenced by changing credit conditions, could vary the volume of international trade.(1) (2)

II. POSITION OF THE BANK OF CANADA

7. The provisions of the Act in 1934 which established the Bank of Canada followed quite closely the suggestions of the Macmillan Report.(3) Particularly was this the case, with regard to public ownership and the concept that Bank policy was subject to Parliament. However, several steps including, partial and ultimately complete nationalization, more government control over Board appointments and the limiting of the Governor's power of veto over Board decisions, changed the original basic concept of the Bank's position and made it responsible to the government of the day (rather than to parliament) and also set out that the Bank should operate in such a way to implement that government's policy.(4) Thus, while it became established that the Bank has freedom in formulating its policy, such policy must be in agreement with that of the Government. In other words, the Bank should have discretion in effecting policy, and the government should have no power to change the methods being used. For this system to function, there

(1) Macmillan Report - paragraphs 206-210, 218, 229-230. See Exhibit 2.

(2) In passing, and as a matter of interest, the Commission felt that the provision in the Bank Act limiting the rate of interest which the commercial banks could charge should be repealed. In those days, the maximum rate was 7%. The problem is still with us and continues to limit the flexibility of rates charged by the banks.

(3) Bank of Canada Report of the First Annual General Meeting of Shareholders, February 25, 1936, page 11. See Exhibit 3.

(4) Several important statements have been made clarifying this matter, among them, that by the Honourable J. L. Ilsley in 1941, with subsequent remarks by G. F. Towers in 1954 and by J. E. Coyne in 1956. Shortly after his appointment as Governor of the Bank of Canada in 1961, Louis Rasminsky echoed these earlier views. See Exhibit 4.

are three basic assumptions:

i. the government's policy must be reasonable and sound and not dictated by political aims.

ii. both the Bank and its Governor must be held in high esteem and their prestige unquestioned, and

iii. there must be the closest of liaison and co-operation between the Government and the Bank.

The unhappy events in 1961 indicate the unfortunate possibilities when any one of these prerequisites is missing. To avoid a repetition of last year's happenings which lowered the prestige of both Canada and its Central Bank, it is suggested that some formal and dignified procedure should be established in the event that there are further disagreements on fiscal or monetary policy between Government and Governor which cannot be resolved. Mr. Rasminsky has suggested the desirability of legislative changes in the Bank of Canada Act to deal with this situation.[1] This seems to make sense in the light of uncertainties created by the Honourable Donald M. Fleming who stated: "....the government would have no power whatever to terminate the terms of office of the directors or the governor"[2] and in a matter of a few months demanded Governor Coyne's resignation.

III. BANK OF CANADA AND DEBT MANAGEMENT

8. While the original Bank of Canada Act (1934) provided for the Bank to act as the government's agent "in the payment of interest and principal and generally in respect to management of public debt in Canada", it, in fact, did not become the government's agent until 1938.[3] This was accomplished by the Loans and Interest Branch of the Department of Finance being transferred to the Bank and called The Public Debt Division. It was thought at the time that this would ensure closer liaison between the Bank and the Department of Finance and that any conflicts might be more easily resolved. Since the objectives of the Bank, as set out in the preamble to the Bank of Canada Act were "..........to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluc-

(1) Louis Rasminsky, Statement July 31, 1961.

(2) House of Commons, February 21, 1961.

(3) Report of the Governor of the Bank of Canada to the Minister of Finance for 1938, page 9. See Exhibit 5.

tuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion..........", and these clearly should be the objectives of government, no serious difficulties were envisaged which would cause fiscal policy and its resultant debt management problems to take precedence over the Bank's monetary policy, which, after all, was presumably, also in everyone's best interests. However, years of war and preparedness for war, together with the growth of the welfare state concept have resulted in a most troublesome conflict of interest position for the Bank of Canada in implementing its policy, and at the same time having to raise enormous amounts of money for the government. Since it is evident that the Government cannot be denied its cash requirements, the basic objectives of sound monetary policy, even combating inflation, have been, from time to time, sacrificed or delayed. It appears that debt management should revert to the Department of Finance, since in this way not only the Department, but the Cabinet as a whole, may be made more aware of the problems of the fiscal policy being followed.

9. While maintaining that debt management should revert to the Department of Finance, it is relevant to make reference to some of the methods used by the Bank of Canada since it took over the function in 1938. Normally, in public issues, the Bank contacts its list of primary distributors which includes the chartered banks, most of the members of the I.D.A.C., stock brokers and others, and is believed to number between 250 and 300. It may properly be contended that this list is too big and unwieldy to be efficient, and that it should be reduced to those organizations which normally position and make markets in government securities. Other dealers, brokers, or agents could apply for bonds (when they have a demand for them) to this group on a split underwriting fee basis. There follows an outline of some of the methods which have been used to place issues:

i. The Bank has purchased entire issues directly from the Government for cash, e.g. Treasury notes during wartime.

ii. The Bank has negotiated on behalf of the government with the chartered banks for the placement, on a formula basis, of illiquid, low-yielding deposit certificates. This was also done in wartime, and again to finance exchange flows around 1950, at which time the banks objected on the grounds that "forced" lending at low interest rates was involved.

iii. The Bank has conducted regular auctions of treasury bills. The Annual Report of the Governor of the Bank for 1956 describes the method used. (pages 46-48) Basically, bills have not been used to any major extent as a method of raising money for the Government, but as a liquidity instrument through which the banks could adjust their reserves with a minimum of difficulty and as an aid in the development of a money market. Increases in 91-day bill outstandings and the issuance of bills with terms of six months, nine months, and one year have taken place as bank assets grew and the money market developed, although some observers now feel that secondary reserves at the banks contain an element of forced lending. It has been suggested that consideration might be given, in the interests of convenience on smaller orders, to alloting amounts up to a specified maximum, in full at the average award, as is the practice in the United States,[1] at the weekly auctions.

iv. Occasionally, the Bank has placed with the banks short-term marketable issues, the proceeds of which have tided over the government temporarily, and have been retired from the funds raised through the sale of Canada Savings Bonds, e.g. in 1954 and 1958. Such issues, unlike deposit certificates, have been priced to yield a fair return and have been liquid in the sense that they were saleable.

v. On various occasions, the Bank and the Department of Finance have recruited personnel from primary distributors for exceptionally large operations, such as the National War Finance Committee for Victory Loans, the Conversion Loan in 1958, and to some extent, the annual Canada Savings Bond campaigns. As a comment on this last, it appears that so much emphasis has been placed on their sale that difficulty is encountered by dealers in obtaining any material distribution of marketable bonds at retail. This is particularly so, since government bonds have been subjected to such wide price fluctuations. It is suggested that Canada Savings Bonds be used, as was the

(1) R. V. Roosa, Federal Reserve Operations in the Money and Government Securities Markets, page 38. See Exhibit 6.

apparent original intent, as a means of saving, rather than an investment medium for funds already saved.[1]

vi. Other methods used range from auctions to tap loans, including firm bonds to primary distributors, subscription privileges (which sometimes meant ordering ten or more times the par value of bonds required), acquisitions or underwritings by the Bank and/or government accounts either for cash or in exchange for maturing or other securities. It is unlikely that the terms, pricing or amount of the offering were discussed with primary distributors, i.e. the organizations and people who would be placing the issue. Even at the time of offering, there have been occasions when the size of an issue has been unknown, due to government or Bank subscriptions which may or may not be re-offered subsequently.

vii. Starting in 1961 and after the government announced that it would stay out of the long market to finance its deficit, there have been some changes in method. The pattern has been about as follows: primary distributors receive an offering of firm bonds (participation determined arbitrarily by the Bank and variable from issue to issue) and usually may order additional bonds, but not more than twice the amount of firm bonds accepted. This is an improvement in that it eliminates some speculation. (i.e. the order is perhaps four times the amount which a primary distributor expects to receive, instead of say ten times or more) It also enables the Minister of Finance to continue to announce that his financing was heavily over-subscribed.[2] However, it precludes a distributor from getting a materially larger allotment because of the arbitrary participation determined by the Bank, even if orders have been received in excess of such allotment.

(1) In his Report to the Minister of Finance for 1946, Mr. Towers stated: "The Canada Savings Bond was designed to incorporate those features of both Victory Bonds and War Savings Certificates most desired by individual savers. The chief purpose of its issue is to facilitate the continuance of regular personal savings habits developed in wartime."

(2) It is not recorded whether the Minister, in making his announcements, blushes with becoming modesty or simply sighs with relief.

On the other hand, if a distributor is unable to (or does not, because he thinks terms or pricing are not appropriate, and being ethical, advises his clients against the purchase of the security) obtain sufficient orders to dispose of the allotment, he must accept his firm bonds and subscribe for additional amounts, or run the risk of a reduced participation in future financing, or perhaps having his name deleted from the Bank's list. Another undesirable feature is that primarily, distributors seldom can advise their customers properly as to the size of the issue (since the Bank may also be a subscriber and may or may not re-offer) and hence the adequacy of the pricing, from the point of view of supply and demand factors, becomes pure guesswork.

10. There have been four occasions (Sep./61, Nov./61, Jan./62 and Apr./62) when the Bank has acquired the entire amount of a new issue and there has been national advertising thereof, mentioning all terms, including par value, price, and yield in bold-face type and below, in small print, the Bank's acquisition. Subsequently, the Bank has re-offered the bonds to primary distributors at or above the advertised price, either for cash or in exchange for other securities. Primary distributors are thus unable to obtain bonds for clients at the advertised price and make a profit.

11. It should not be necessary to mention that such methods of offering securities would be unlikely to be approved by any Provincial Securities Commission. Such clearance is, of course, unnecessary for government offerings.

12. The above may sound like, but is not intended to be, a condemnation of the Bank of Canada. Rather, it is designed to point out that because of the inadequacies of Canadian fiscal policy, and since it has to be accepted that the Government-of-the-day must have its cash requirements, the Bank, as the debt manager, has become a victim of circumstances and has had to resort to any methods available to it to raise the money, in the face of a growing and widespread distrust of marketable Government of Canada long-term bonds as an investment medium.

13. With debt management in the hands of the Department of Finance, there is no reason why the Bank would not continue to co-operate and provide impartial and sound advice but the Department should, in addition, recruit advisory committees from dealers, banks and investing institutions, as is done in the United States. The advice so obtained would reflect the state of capital markets, investor demand for specified term categories of bonds, coupons, yields, method of offering,

etc., and would be the most expert and practical available. It may even be considered desirable, in due course, presuming a reasonable fiscal policy, to make use of what has been the most successful method of borrowing by others, i.e. negotiated transactions with dealer syndicates.(1) This method is described in detail in appendix "B" to this brief. Suffice to say here that syndicate members with a liability in the account would, generally speaking, be limited to those organizations which are active in making trading markets and which normally position government securities.

IV. BANK OF CANADA FUNCTIONS

(i) General

14. Before outlining some of the tools available to the Bank to put its policy into effect, it might be well to set out some of the problems which such policy is expected to resolve. Its most important function is to vary the level of the national income and prices, up or down, as conditions indicate, through changes in the chartered banks' cash positions. In order to keep their ratios at the customary level, such variations will tend to induce the banks to change their policies regarding loans and/or investments which, in turn, will change both the cost and availability of credit. Some of these changes may be purely seasonal,(2) and because they tend to reverse themselves in due course they seldom require more than temporary offsetting action by the central bank, and since they are seasonal, they can be anticipated and preparations can be made in advance. There may also be temporary reasons for change which cannot be anticipated and hence require more skill in handling. Among these are substantial inward or outward movements of capital, the government being temporarily out of funds and, perhaps, on occasion in recent years, the results of the Bank being a lender of last resort to banks and money market dealers. Despite the fact that these conditions are only temporary, they may require quick offsetting action by the central bank in order not to create conditions which would be contrary to the monetary policy being pursued at the time, nor to result in disorderly markets for exchange or securities. Finally, there are situations which require more permanent change, such as growth in population and gross national product. In the initial stages

(1) See Exhibit 7.

(2) For example, farm and grain loans, loans against Canada Savings Bonds or heavier public demand for cash during holiday periods.

of such a trend, the banks can sell securities to meet loan demand, and velocity of turnover may increase. However, there are limits to both of these possibilities, and in any case, if carried far enough, they might cause the bond market to be seriously disrupted, making long-term capital borrowing more costly or difficult. Under such circumstances, the Bank must increase the cash reserves of the chartered banks, or foreign borrowing may increase to a point where exchange rates are disrupted. Such changes in monetary policy require fine judgment in order to ensure that productivity, and not price, increases remain dominant. R. V. Roosa in his pamphlet on Federal Reserve Operations, aptly refers to these functions as "the defensive, avoiding mechanical disturbances that could interfere with the smooth functioning of the monetary system, and the dynamic, using the potentialities of control over the reserve base of a fractional reserve banking system to help promote economic growth within a pattern of sustained stability."

(ii) Broadening the Government Securities Market

15. There is a situation which must be improved by a central bank, or the tools at its disposal will have limited impact, and that involves the progressive broadening of the government securities market. To increase the liquidity of the market, over the years, the Bank of Canada has taken the initiative with several steps and substantial progress has been made. Regular treasury bill tenders were inaugurated in 1934, culminating in weekly auctions in 1953, including those for bills with terms longer than three months. During its existence, the Bank has always been available to the chartered banks as a lender of last resort but it started, in 1953, to make its discount window available to selected dealers and did a substantial volume of short-term purchase and resale agreement transactions with them.(1) In 1954, changes in the Bank Act made possible, for the first time, the real beginnings of a money market(2) in Canada which, through a more liquid bill market and the movement of day-to-day borrowings by dealers, enabled the chartered banks to adjust their cash without dealing directly with the Bank of Canada, and also resulted in non-bank liquidity-conscious investors becoming important holders of bills and other short-term government securities.(3) From

(1) Report of the Governor of the Bank of Canada to the Minister of Finance for 1953, page 8. See Exhibit 8.

(2) For a description of a money market and its functions see Standing Committee on Banking and Commerce, March 16, 1954. See Exhibit 9.

(3) Report of the Governor of the Bank of Canada to the Minister of Finance for 1954, pages 11-12. See Exhibit 10.

time to time, the Bank has taken the initiative in causing a reduction in the costs of handling securities, through providing free and simultaneous out-of-town transfers at its agency points, reduced overcertification charges and free movement of day loans within the banking system.[1] It has also from time to time provided borrowing facilities in securities through sale and repurchase agreements with dealers. Obviously, the government market has been greatly developed, making it more sensitive to supply and demand factors and, therefore, to Bank of Canada action.[2]

16. Recently, discussions have been underway, between the Bank of Canada and dealers, regarding a market for bankers' acceptances. Another field to be explored might be the extension of the Bank's lender of last resort facilities to selected dealers, with collateral being Canadas beyond the money market term range of three years. This, with flexible, special, call loans at realistic rates at the chartered banks should in time broaden the market for mid and longer term government bonds.

(iii) Statistical Material

17. The Bank has had success in other directions. For example, its research department makes excellent statistical material available, on a weekly and monthly basis, which not only indicates the direction of central bank activity but shows changing trends in other segments of the economy. This material is invaluable to business and all levels of government in arriving at policy decisions. If any criticism may be cited in this respect, it would be in the lack of explanatory or illustrative articles to complement the bare statistics, other than the comments in the Annual Reports of the Governor to the Minister of Finance and occasional public addresses and parliamentary hearings by Messrs. Towers and Coyne.[3]

(1) For a detailed analysis see "Broadening the Money Market" by R. M. MacIntosh, Canadian Banker, Autumn 1954.

(2) For a description of the functions of a money market see Chapter 7, "Foreign Central Banking, The Instruments of Monetary Policy" by P. G. Fousek, which also describes the broadening of the Canadian market. The London and New York markets are described in "Federal Reserve Operations in the Money and Government Securities Markets" by R. V. Roosa. Both are publications of the Federal Reserve Bank of New York.

(3) In the United States, each of the twelve Federal Reserve Banks publishes a monthly bulletin which contains articles of national and local interest. In addition, the Board of Governors of the Federal Reserve System has monthly publications which are invaluable. All of these contain articles, reproductions of speeches of senior officers of the banks, etc., which enlarge on available statistics. Each also has an annual report edition, and periodically, informative booklets are published.

Such documentation would be most useful to educational bodies, and would have facilitated the writing of this appendix.[1] One mechanical recommendation would be the publication of bond holdings of the Bank and the chartered banks, in term categories of three years and under and over three years, to conform to the terms of reference on money market securities. Another would be making available statistics indicative of overall public liquidity, including holdings of commercial paper and government (Federal, Provincial and municipal) securities due in less than one year as well as publicly held money supply and outstanding Savings Bonds.

V. BANK OF CANADA'S BOARD OF DIRECTORS

18. There is, however, one situation where there appears to be room for improvement. The Macmillan Report stated that it was vital that the management and Board of Directors of the Bank should be filled by persons with the highest degree of experience, skill and integrity.[2] The government does not seem to have been successful in appointing to the Bank's Board people whose skill or experience appear to qualify them to assist, materially, the Governor and his senior personnel.

19. Working from the reports of the Bank of Canada since its inception, there appears to have been 44 directors (excluding the Governors, the Senior Deputy Governors and the Deputy Ministers of Finance) who have served about 300 man-years. Little information is available on some of them as to their "experience and skill" in financial matters and several did not appear in publications such as "Who's Who in Canada" during their terms as directors. Adding together the man-years served of those who are known to have been, prior to, during, or subsequent to their terms of office, investment dealers, stock brokers, officers or directors of life insurance companies, officers or directors of chartered banks, officers, directors or members of advisory boards of trust companies or economists. the total comes to about 125 (after eliminating duplications in the above-mentioned categories). This is not to question the integrity of, nor to belittle the advice the others might have been able to provide to the Governor on such matters as the crop outlook, conditions in certain industries, etc., nor their political value. However, considerably more than one-half of the man-years served by outside directors of the Bank have been served by men whose educational background and business experience appears to have been non-financial. Steps should be taken to remedy this deficiency and in any case the selection of the directors should be based on competence and qualifications and not on racial or religious

(1) The Report of The Committee on the Working of the Monetary System made similar recommendations respecting the Bank of England and subsequently the Bank's Central Banking Information Department has been issuing a most informative Quarterly Bulletin. See Exhibit 11.

(2) Macmillan Report - paragraph 227. See Exhibit 12.

grounds, place of residence, political affiliation or social position.[1] An appropriate Board of Directors would not only be helpful to the senior officers of the Bank in their deliberations, but would enhance the Bank's prestige and possibly create an atmosphere of independence from government on policy matters, because of their recognized intelligence and importance in the business and financial spheres. In the interests of providing the Governor with genuinely useful guidance, it is suggested that a knowledgeable Executive Committee be selected from the Board which should meet frequently, possibly fortnightly, with the entire Board meeting at least once a month. In addition, consideration should be given by the Bank to the appointment of advisory committees, such as those suggested for consultation with the Department of Finance.

VI. BANK OF CANADA AND MONETARY POLICY

20. Most of the traditional tools of central banking are available to the Bank of Canada. Some have not been used and others have been, with wide variations of success. Basically, the most important and effective method of central bank control has been the variation of bank reserves (expansion or contraction of the money supply) and this may be accomplished in several ways. This is so-called quantitative control:

(i) Open-market operations

21. Obviously, by buying or selling securities the Bank can affect the deposits and hence the reserve ratios of the chartered banks.[2] However, there must be a market for securities for open-market operations to be effective, and the Bank of Canada has taken the initiative in broadening the market with some success, as has been indicated above. In addition to market operations, the Bank can have the same effect on bank reserves at the weekly bill tender by buying more or less of the current issue than it holds of the one which co-incidentally matures. Since Bank policy should always be directed at stabilizing the economy, its market operations should not cause disruptions in the government market, (in the sense

(1) For a description of the selection of directors of the Federal Reserve Banks, see Chapter IV of The Federal Reserve System, Purposes and Functions, 1961 edition. The Court of the Bank of England is described in paragraphs 752-753 in the Committee on the Working of the Monetary System Report. The Bank of Canada Act, sections 5-14, indicates management requirements of the Bank.

(2) The effects of open-market operations in a fractional reserve banking system are described in:

1. The Federal Reserve System, Purposes and Functions, 1961 edition, pages 20-23, and
2. Memoranda and Tables re Bank of Canada given before the Standing Committee on Banking and Commerce, House of Commons 1939, pages 30-34.

that violent fluctuations can be avoided) since, it is, of course, the key market and determines the rates at which lesser credits may borrow.[1] The Bank seems consistently, over the years, to have under-estimated the psychological effects of its market operations, which periodically have created excessive speculation and something resembling panic. After all, the Bank is the largest single holder of Canadian government securities. It does not hold them for investment purposes in the sense that most investors, such as chartered banks, insurance companies, pension funds, trust companies or individuals do, i. e. for security, liquidity or income. The Bank's investments are held so that it can change the liquidity position of others (or as a result of having made such changes). Thus, the effects of its market operations have a tremendous psychological, as well as an actual impact on investors in general, necessitating great deftness and skill in handling if markets are not to be disturbed.

22. For many years, the Bank of Canada has operated in all term segments of the market. Mr. Towers[2] explained that trading in longer-term governments was designed to broaden the market and he expressed the hope that the Bank could in future play a smaller part, as dealers expanded their operations. Mr. Coyne[3] pointed out some of the circumstances under which the Bank bought and sold securities. His statement seemed to suggest that the Bank preferred to operate as a result of dealers initiating the selling or buying or if it became necessary to mitigate fluctuations. The Radcliffe Committee's Report[4] indicated that the Bank of England should operate in longer issues to prevent disorderly markets and if it became desirable to change the liquidity position of the "private sector". Stress is on operations in the bill market, as far as money management is concerned.[5] W. W. Riefler[6] described the policy of the Federal Reserve System in its market operations since 1953 and concluded that, since buying or selling bills

(1) It has become customary for professional investors to establish a notional yield differential between Canada bonds and those of lesser credits. This yield spread varies from time to time for many reasons, but always exists.

(2) Standing Committee on Banking and Commerce, March 18, 1954. See Exhibit 13.

(3) Standing Committee on Banking and Commerce, May 15, 1956. See Exhibit 14.

(4) Report of the Committee on the Working of the Monetary System, paragraphs 339, 340, 373. See Exhibit 15.

(5) Foreign Central Banking: The Instruments of Monetary Policy - Fousek - pages 34-35. See Exhibit 16.

(6) Open Market Operations in Long-Term Securities - Federal Reserve Bulletin, November 1958, page 1260. This article should be read in its entirety.

had the same effect in varying bank cash as trade in any other segment of the market, a bills only (or preferably) policy was justified. Furthermore, operating in longer bonds tended to widen their price fluctuations from cycle to cycle and was not justified, except to smooth out disorderly markets. Mr. Riefler's concluding remarks were as follows:

23. "The decision of the Federal Open Market Committee in 1953 to confine open market operations to short-term issues reflected primarily realization that the Government securities market occupied a crucial position in the postwar financial structure and a desire to promote the better technical functioning of that market by minimizing disturbances that might result from the System's own operations. Since the bill sector was very much broader than any other sector of the market, it was clear that such disturbances would be held to a minimum if System operations were confined primarily to bills. The decision of the Committee reflected its confidence that confining operations to the shortest term securities would improve and not impair the market effectiveness of Federal Reserve policy actions.

24. "Basically, the System aids the economy in times of recession by increasing flows of loanable funds and thus helping to finance active demands in the markets for men and materials. This is the ultimate aim of monetary policy at such a time. The achievement of lower interest rates in these circumstances represents a means to an end, not an end in itself. The effective monetary stimulant to the economy in time of recession is an increase in the availability of reserves to the member banks, since such reserves increase by a multiple factor the supply of funds available for loans and investments and also help to create a financial environment in which additional credit-worthy enterprises are both tempted and able to borrow. This stimulant can be provided just as effectively by operations in bills as by operations in bonds.

25. "Conversely, the System acts to restrain over-ebullience in the economy when it decreases the rate of credit creation at the commercial banks, thus minimizing excess pressure on the markets for goods and labor. The relief of this pressure, not higher interest rates, long- or short-term, is the object of a policy of restraint. The effect of such restraint in the face of active demands for credit will, of course, take the form of higher interest rates which will help to bring total money demand into line with resource availability. When open market operations are used, it is the lessened availability of bank reserves that effectuates this restraint, not the fact that the security sold in

conducting the operation was a long-term bond. Sales of bills are fully as effective in absorbing reserves from the member banks as sales of long-term bonds. More important, they minimize the risk of creating a condition of disorder in the securities market, which might force intervention by the System to support the market at a time when broader economic considerations called for restraint.

26. "The difficult problem for the System in periods of recession or boom is to diagnose the state of the economy and particularly the tempo of the money and capital markets through which policy actions influence economic activity. The System must at all times act on a judgment as to the volume of reserves that is most appropriate to sustained economic growth and stability. The formation of such a judgment involves a process of continuous evaluation in which the System is always, in a sense, probing the unknown and feeling its way.

27. "The difficulty of deciding on the appropriate volume of reserves is magnified when the most relevant indicators of conditions in the long-term capital markets are deflected by transient or short-run responses to the System's own operations. It is minimized when the System is able to effectuate changes in the reserve position of the banks through operations that cause little if any immediate change in expectations, particularly unjustified expectations with respect to long-term yields. The outstanding advantage of open market operations confined to short-term securities is that they meet this criterion."

W. McC. Martin[1] confirmed the desirability of the Fed staying the short market, but in 1961 the outflow of funds in the face of a need for easy credit caused it to adopt a policy of buying longer securities to enlarge bank cash. (operation nudge) Mr. Martin described these operations in January, 1962[2] and implied some concern over the high proportion of trading done by the Fed, particularly in bonds due in more than ten years. Mr. J. L. Robertson, of the Board of Governors of the Federal Reserve System, urged that operations beyond the short term area be terminated immediately in a dissent to the December 19, 1961 directive to the Federal Reserve Bank of New York.[3]

28. The framers of the original Bank of Canada Act (1934) apparently did not recognize any great necessity for the Bank's market operations to extend beyond bonds due in less than two years, since its holdings of longer bonds (including provincials) were limited to three times its paid-up capital or $15 million. There have been several amendments to this proviso, but even in 1954, prior to

(1) Federal Reserve Bulletin, March 1961, page 272. This statement before the Joint Economic Committee should be read in its entirety.

(2) Federal Reserve Bulletin, February 1962, page 131. This statement before the Joint Economic Committee should also be read in its entirety.

(3) Annual Report of the Board of Governors of the Federal Reserve System 1961 summarized the basis of Mr. Robertson's dissent. Pages 97-98. See Exhibit 17.

the amendment which removed all such restrictions, holdings of bonds maturing in more than ten years were limited to $75 million.(1) Since treasury bills appear to have been created to be used as a liquidity instrument, the weight of evidence seems to indicate that the Bank of Canada should conduct its open-market operations within the defined money market range (maturities of three years or less), with some emphasis on bills "preferably", excepting during periods of crisis when the orderly market(2) concept should properly prevail in all term categories.

29. There is a further matter concerning open-market operations in Canada to be considered. While recognizing the necessity for the Bank's Head Office and senior officials being located in Ottawa, trading markets are, in fact, in Toronto and Montreal, and yet the Bank's trading desks in these cities are understaffed and the traders are not given sufficient authority to deal at their discretion.(3) Not only does this slow down trading,(4) but the traders have insufficient time to discuss market conditions, expectations, etc. with the dealers in order to get the "feel" of the market and sometimes this is more important than technical projections of probabilities. This could mean that those, in Ottawa, on whom the responsibility for policy decisions rests, may not be close enough to the market to make appropriate judgments. Enlarging the staff of the trading departments in the two principal trading centres seems to be indicated.

30. The Bank has another trading problem, since it stands ready to deal with all of its primary distributors from coast to coast. In recognition of this problem it has, in effect, eliminated many of these dealers by setting minimum amounts ($250,000 in bills and Canadas due within three years and $100,000 in longer bonds) in which it will deal. By way of simplification, consideration might be given to limiting trading to those organizations which endeavour to make markets, and which would, then, become jobbers for all other dealers.

(1) Holdings of bonds due in over ten years, as of July 31, 1954, were $33 million and as of December 31, 1961, were $1,186 million. Month-end high was $1,351 million in June 1959. A major part of this increase was brought about by the Conversion Loan of 1958.

(2) Committee on the Working of the Monetary System Report, paragraph 551, See Exhibit 18, and
Federal Reserve Bank of Philadelphia, 1954, "Quest for Stability", pages 18-19. See Exhibit 19.

(3) This problem of liaison seems to have received more recognition in the United States, R. V. Roosa, Federal Reserve Operations, pages 94-95. See Exhibit 20.

(4) Inability to deal over the telephone tends to create apprehension and from time to time leads to speculation and larger offerings or bids than exists from business on hand.

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(ii) Operation of Government Accounts

31. Since the Bank of Canada is the Government's banker, it holds in the Receiver General's Account some of the Government's cash, the balance being on deposit with th chartered banks. The proportion held by the Bank may be varied resulting in "draw downs" (decreases in cash) or "re-deposits" (increases in cash) for the chartered banks, both of which alter their cash ratios. The Government has other accounts for which the Bank acts as agent and changes in their holdings may also alter the chartered banks' cash positions. Among these accounts are:

32. The Securities Investment Account, which is used to invest surplus government cash, acquisition of bonds for cancellation, purchase of external-pay bonds when exchange rates are favourable, etc. According to a press release from the office of the Minister of Finance, dated November 8, 1961, certain holdings of government bonds in the account, totalling some $82 million, were cancelled.(1) This had at the time bullish implications for bond prices, since these bonds could have been sold in the market when the government required cash. Instead, it chose to raise new money in one of its frequent cash borrowings in the short-end of the market. Another type of use to which the account has been put took place in February of both 1961 and 1962. On these occasions, the account acquired, temporarily, bonds on a purchase and resale basis from the Bank of Canada, in order to reduce seasonally expanded chartered bank cash without open-market sales which might have disturbed the market and would have had to have been reversed in any case.

33. The Unemployment Insurance Fund which, due to portfolio changes adopted in 1961, is no longer the important factor it once was.(2) Actually, its operation by the Bank in prior years was often contrary to the Bank's monetary policy, e.g. in periods of recession and unemployment, the Bank's policy would normally be expansionary, and yet to put the Fund in cash to meet its requirements, its holdings of bonds had to be sold. Seasonal factors were also upsetting from time to time.

(1) A further $37 millions were cancelled as of March 31, 1962.

(2) According to a press release from the office of the Minister of Finance, dated October 2 1961, government bond holdings of the Fund, totalling $201 million, were cancelled and replaced, after repayment of advances from the Treasury, with non-marketable redeemable $3\frac{3}{4}\%$ bonds.

34. The Purchase Fund[1] will likely be used to acquire mid and long-term bonds for cancellation, to influence the yield structure and to stabilize the market. The effect of this fund is similar to that of a sinking fund and, as such, it should prove to be beneficial in time. In periods of budgetary surplus, the use of the Fund can result in retirement of debt in advance of maturity, and the market level of certain term segments can be influenced. However in deficit periods, it adds to the cash borrowing requirements of the government and involves the issuance of additional securities, presumably, in a different term category. Thus, while one part of the market may be supported, another could be adversely effected. It may also be costly.[2] It is not clear whether bonds acquired and held in the Fund, but not yet cancelled, may be re-offered for sale to the market. It seems apparent that this should not be the case.

35. Evidence seems to indicate that on some occasions the Bank's handling of transactions for these accounts has left something to be desired. Whether the fault lies with the Bank's periodic lack of feel for the market, or the Department of Finance's decisions, or as a result of having to operate, from time to time, in a manner contrary to intended monetary policy, is not clear. However, one of the basic fundamentals of successful bond trading is to complete transactions with a minimum amount of disturbance to the market. Such has not always been the case.

36. Exchange Fund Account

Purchases or sales of exchange, whether they be for the Bank's own account or for the Exchange Fund Account, may tend to contract, or enlarge, chartered bank reserves. However, operations to vary reserves in this manner must be harmonious with policy regarding

(1) The Purchase Fund was established by the June 20, 1961 Budget, House of Commons. See Exhibit 21.

(2) e.g. As of November 7, 1961, about $61 million of securities held by the Fund were cancelled. The average coupon on these securities was 4.49% and the average term to maturity $18\frac{1}{2}$ years. In September, 1961, the government issued 5-year, 3-month $4\frac{1}{2}$'s ($4\frac{1}{2}$'s due December 15, 1966) to yield 4.66%. On March 31, 1962, an additional $105 million was cancelled.

N.B.

The cancellation, since Autumn 1961, of the marketable bonds in the Securities Investment Fund, the Unemployment Insurance Fund and the Purchase Fund, totalling some $486 million, has been cynically referred to by some observers as "reversing" the 1958 Conversion Loan.

exchange. Since 1952 (after the Foreign Exchange Control Board was abolished) the Bank of Canada has operated the Fund for the Government and, until recently, has apparently been content to stabilize and maintain an orderly day-to-day trading market, and to minimize wide fluctuations, while letting the dollar find its own level. Canada's holdings of gold and U.S. dollars were $1,860 millions at the end of 1952 and $1,829 millions in 1960, which is indicative of the relatively small over-all effect of the operations. This may have been the result of the terms of Canada's membership in The International Monetary Fund which permitted an unpegged exchange rate, provided the rate was not manipulated. Also, there appears to have been the thought that the flow of foreign funds in or out of Canada could be influenced more readily (and perhaps more economically) by changing government bond yields through monetary policy.[(1)] However, in 1961, the government through avowed policy[(2)] and substantial operations in the exchange market, definitely influenced, downward, the value of the Canadian dollar in international markets. By the end of 1961, holdings of gold and U.S. dollars had risen to $2,056 millions, an increase of $227 millions during the year, despite a transfer to The International Monetary Fund of $50 million. In the first three months of 1962 however. pressures were in the opposite direction and exchange holdings dropped by $347 million.[(3)] Figures showing holdings of gold and U.S. dollars are released monthly, which seemed adequate prior to 1961. Since then, the swings have been so large that the publication of weekly figures would be helpful.

37. In its trading of exchange, the Bank has seldom operated in the futures market, despite the fact that spot transactions may cause a maldistribution of chartered bank cash or require offsetting action.

(1) Hence, the close attention paid to yield spreads between Canadian government bonds and those of other countries, particularly the United States.

(2) House of Commons, Budget Speech, June 20, 1961. See Exhibit 22.

(3) See Exhibit 23 for comments on exchange policy by W. Earle McLaughlin at the Annual Meeting of The Royal Bank of Canada, January 11, 1962.

The Honourable Donald M. Fleming denied some of Mr. McLaughlin's allegations in his Budget Speech on April 10, 1962.

R. V, Roosa, Under Secretary of the Treasury for Monetary Affairs made some comments on exchange policy in an address before the American Bankers Association in New York City on February 7, 1962.

Since there are some seasonal movements of funds internationally which tend to reverse themselves, transactions in futures appear to be a simpler course. Furthermore, international, short-term "hot" money flows on a hedged basis, may be discouraged when such action is deemed to be appropriate, by activity in the futures market designed to alter the relationship to spot rates. In view of our recently altered exchange policy, a full examination of the situation seems to be desirable in order to determine the adequacy (or otherwise) of our gold and U.S. dollar reserves, our position vis-a-vis The International Monetary Fund and the possible effects on our balance of payments.

(iii) Regulation of chartered banks' cash reserves

38. Cash reserves have traditionally become considered to be the liquidity cushion enabling a bank to meet its customers' demands for currency and to pay cheques drawn by its depositors, i.e. they ensure adequate liquidity in the banking system. The establishment of a minimum cash ratio for the banks (whether it is varied from time to time, or not) provides the basis from which the central bank's open-market operations may secure their intended results.(1) This becomes evident, since it is accepted that if a bank experiences difficulties in maintaining its reserves at the required level, it is obviously in an over-extended position and corrective measures such as converting secondary reserves into cash, calling loans, etc., become necessary.

39. Since 1954, the Bank of Canada has had the power of varying the chartered banks legal cash ratio between 8% and 12% of their deposit liabilities, the change not to exceed one percentage point at a time, and on one month's notice. The ratio was set initially at 8% and has not been changed. This compares with a 5% requirement previously (calculated in a different way) and a 10% rule of thumb which had been maintained by the banks for many years. The development of the money market, which provided day loans and greater bill liquidity, enabled the banks to work down from 10% to close to 8%. Mr. Towers felt that the Bank's power to alter the cash ratio should be used only in some emergency, such as when cash increases sharply under peculiar and unavoidable conditions, and when off-

(1) Bank Reserves, 1956 printing, page 10. Published by the Federal Reserve Bank of New York. See Exhibit 24.

setting action is precluded or undesirable.[1]

40. Late in 1955, the Bank induced the chartered banks to "agree to endeavour to maintain", in addition to their cash reserves of 8%, secondary reserves of 7% of deposits, consisting of cash, day loans or treasury bills,[2] a total of 15% in all. This is not a legal requirement, but the banks are still living up to their "voluntary" agreement, despite their initial objections to it. The measure now seems to be of doubtful value (presuming that banks will continue to be reasonably cautious in their lending policies and desire satisfactory liquidity), since under tight credit conditions the banks may be willing to sell other less-liquid securities, i.e. mid and longer-term Canadas, in order to make loans, which could lead to a disorderly bond market, unless supported by the Bank, which would be contrary to intended policy. On the other hand, when the banks have excess liquidity above the 15%, the requirement is ineffective in limiting credit. It may also be criticized on the grounds that it makes the banks a "captive" market for bills and, hence, the government could be accused of forced lending.[3]

(iv) The Discount Rate

41. As the lender of last resort, a central bank usually establishes a minimum rate at which it will extend short-term advances against suitable collateral, to authorized bodies such as banks, which may require advances to replenish their reserves when some unexpected situation temporarily exhausts cash. Traditionally, the rate has been fixed and changes in it not only signal the expectations and intentions of the central bank, but also have led to changes throughout the entire interest rate structure, i.e. credit tends to become cheaper or more costly, as the case may be, as the bank resists deflationary or inflationary pressures. If used in conjunction with appropriate open-market operations, both the availability and cost of credit tend to be altered. As discount rate changes become understood, they have a psychological (as well as an actual) impact on investors, and thus, may tend to lessen the extent of complementary open-market operations (or other actions) necessary by the central bank to attain its intentions. In Canada, little use of the Bank's discounting facilities were made

(1) House of Commons- Standing Committee on Banking and Commerce, March 18th and March 23rd, 1954. See Exhibit 25.

(2) Report of the Governor of the Bank of Canada to the Minister of Finance for 1955, pages 16-17. See Exhibit 26.

(3) Excerpts from James Muir's address to the Annual Meeting of The Royal Bank of Canada, January 9, 1958. See Exhibit 27.

until 1953, when the money market began to function. In 1954, a number of investment dealers were given "lines of credit" with the Bank, and began using the discount window quite extensively. Similar, but more official "lines" had been given to the chartered banks many years previously.[1] Several changes were made in the rate during 1955-1956, but as of November 1, 1956, the Bank announced that the rate would, in future, be permitted to fluctuate each week at a level of $\frac{1}{4}$% higher than the weekly average award on three-month treasury bills.[2] As a surmise, one may ponder whether the Governor felt that, since his efforts to contain credit in 1955-1956 had not been successful, fiscal policy had taken precedence over monetary policy. If so, he may also have felt that a much higher discount rate might draw public attention to his dilemma.

42. The establishment of a "floating" rate appears to have accomplished little--indeed, it may have hampered the Bank in implementing its policy since it is generally recognized that the simultaneous use of more than one tool by a central bank, e.g. open-market sales in conjunction with an increase in the discount rate, is helpful in attaining the desired result. Recently, too, there have been examples in other countries of the use of changed discount rates to influence the movement of short-term capital between countries where such flows were considered undesirable. Furthermore, the changes in the fixed rate in 1955-1956 were beginning to have effects on other interest rates (i.e. creating flexibility) and the "disturbing" effects to business may have been desirable under existing conditions of extraordinarily high capital investment. There may be some justification for the rate involving a penalty,[3] but the $\frac{1}{4}$% above current bill yields does not guarantee such a penalty on all the securities which may be eligible collateral for advances. However, minimizing the penalty aspect has some merit since, from time to time, it may enable money market dealers to carry substantial inventories of short-term securities, thereby tending to maintain a broad and active market. Some observers have commented that if the floating rate were replaced with an administered rate and the differential between

(1) For comments on the Federal Reserve's discount window, see pages 24-25, "Federal Reserve Operations in the Money and Government Securities Markets, by R. V. Roosa. See Exhibit 28.

(2) See Exhibit 29 for dates and changes in the discount rate, together with official comments in connection therewith.

(3) The banks are, in effect, penalized by having to pay interest on advances for seven days and yet receive a credit for only five, in maintaining their cash ratios. Both the banks and the dealers may have to pay a rate in excess of the discount rate on renewals of advances, or use of advances on more than one occasion during a calendar month. The same applies on advances in excess of specified lines of credit. In the case of dealers, lines of credit are renewed or changed monthly and such changes may penalize a dealer by limiting his operations. On the other hand, a Federal Open Market Committee directive, dated December 19, 1961, authorized the Federal Reserve Bank of New York "to buy U.S. Government securities with maturities of 24 months or less at the time of purchase,......from non-bank dealers.....under agreements for repurchase of such securities.....in 15 calendar days or less, at rates not less than (a) the discount rate of the Federal Reserve Bank of New York.....or (b) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower". Under normal circumstances, the applicable rate would be lower than the discount rate, indicating that the penalty aspect is not considered to be important. (Annual Report of the Board of Governors of the Federal Reserve System for 1961, page 92).

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it and treasury bill yields widened significantly beyond $\frac{1}{4}\%$, dealer willingness to carry large inventories might be lessened which in turn might tend to narrow the market. On the other hand, under these circumstances, the Bank might like to see a smaller spread with bill yields closer to the Bank rate. Since any validity a floating rate may have had in 1956 no longer seems to exist, a return to an administered rate appears to be desirable.[1] Any changes should be accompanied by an explanatory statement from the Governor, and supporting remarks by the Minister of Finance may be appropriate on some occasions. By way of corroboration of this suggestion, no other central bank in any country in the world, with a money market, has adopted a floating rate.[2]

43. From time to time, one hears discussion of a suggestion that rates against actual advances be set so as to ensure the penalty aspect, with an accompanying official discount rate which is published as an indicator of monetary policy, but is not the rate at which borrowings take place. For the Bank of Canada to have dual rates does not seem to make much sense, if it does not lend at one of the rates. Indeed it might dilute the effectiveness of the "signal" rate.

44. In all the quantitative controls outlined above, only the chartered banks are directly affected. It would appear that if credit control is to be fully effective, other bodies which accept deposits and make loans (i.e. trust companies, finance companies, etc.) should be subject to equally effective regulation.[3]

(v) Moral Suasion

45. In addition to the above quantitative controls, there is the aspect of qualitative control, or moral suasion (or "open-mouth" policy, as it is sometimes called) which is perhaps the most difficult to describe of the tools available to a central bank. Involved is an endeavour to cause some group, which has some control over the extension of some type of credit, to modify its policy temporarily. Theoretically, there can be no compulsion and the "suasion" has no legal backing. It is the closest the Bank of Canada can come to selectivity in its endeavours to vary the availability of credit.

(1) See Exhibit 30 for comments concerning the discount rate by:
James Muir- Annual Meetings of The Royal Bank of Canada, January 9, 1958 and January 14, 1960,

G. Anrold Hart- Annual Meeting of the Bank of Montreal, December 5, 1960,

J. Douglas Gibson - Annual Meeting of The Bank of Nova Scotia, October 31, 1960,

"Quest for Stability" Federal Reserve Bank of Philadelphia, 1954.

(2) Mr. Rasminsky also implied doubts about a floating rate in his 1961 Report by stating: "......this method of determining Bank rate has given rise to a good deal of public discussion, and many and varied preferences for alternative methods have been expressed ......I hope and expect that the views of interested parties will be made known in evidence before the Royal Commission and it is my present intention to keep an open mind on the matter until all those with a major interest in it have had a chance to express their opinions."

(3) Report of the Governor of the Bank of Canada to the Minister of Finance for 1956, pages 26-27, and also - James Muir - Annual Meetings of The Royal Bank of Canada on January 10, 1957 and January 14, 1960. See Exhibit 31.

46. To be successful, it is obvious that the Governor must be held in high esteem by those whose policy he seeks to influence. His prestige should not be lessened by too frequent resort to moral suasion, (since he is unlikely to be successful in every attempt) his aims must be reasonable, and he must be able to present his case with conviction to those concerned. Threats or arbitrary action can not be used, since there is no legal backing for either, and the request should be for a temporary period only, otherwise, it might appear that the Governor is disregarding the legislative powers of parliament which would involve a change in regulation supported by law.

47. There is no way of knowing how often, nor when, the three Governors of the Bank of Canada have attempted to use moral suasion. However, some instances have been referred to in the Governors' Annual Reports and others have been commented upon in parliamentary hearings. Some examples may be illuminating, since they illustrate the scope of the attempts and their success, or otherwise.

48. In 1936, the Bank influenced stock exchanges and chartered banks to raise margin requirements on loans against stocks.[(1)]

49. In 1946, the chartered banks were requested not to hold more than 90% of their savings deposits in government of Canada securities (ex bills) and to limit the rate of earnings thereon.[(2)]

50. In 1948, it was suggested to the chartered banks that it was undesirable to finance corporate capital development through bank credit.[(3)]

51. In 1951, the banks agreed to attempt to limit further expansion of bank credit.[(4)] In the same year, the Bank may have asked life insurance companies to limit their purchases of new-issue securities to current income.

52. In 1955, the chartered banks agreed, at the Bank's request, to endeavour to maintain a specified proportion of secondary reserves.

(1) Bank of Canada - Second Annual Meeting of Shareholders, February 23, 1937, page 16, and

Standing Committee on Banking and Commerce, House of Commons, June 27, 1944, See Exhibit 32.

(2) Report of the Governor of the Bank of Canada to the Minister of Finance for 1946, page 14. See Exhibit 33.

(3) Report of the Governor of the Bank of Canada to the Minister of Finance for 1948, pages 7-8. See Exhibit 34.

(4) Report of the Governor of the Bank of Canada to the Minister of Finance for 1951, page 9. See Exhibit 35.

53. Also in 1955, the chartered banks again agreed to limit term lending and to report to the Bank unused commitments for such lending.[1]

54. In 1956, the stock exchanges were urged to curtail credit extended on a margin basis.[2]

55. Also in 1956, the Bank attempted to get agreement from finance companies and departmental stores to prevent increases in the extension of credit.[3]

56. In 1957, the chartered banks were urged to maintain their rate of N.H.A. mortgage investment and the notional idea of separating savings and commercial deposits was re-introduced.[4]

57. In 1959, the chartered banks agreed to be most careful in their lending policies and to avoid an increase in loans, if possible.[5]

58. In 1960, in his Annual Report and in public addresses, the Governor stressed the concept that high interest rates were necessary in Canada to attract savings. This idea may also have been in his mind when the Bank supported the Conversion Loan in 1958.

59. In August, 1961, the Governor suggested to certain firms (all members of the I.D.A.C.) that it would be undesirable for borrowers to resort to the American market. This directive was rescinded in March, 1962.[6]

60. Apparently, many of these suasion efforts were effective, while others, by the admission of the Governor, were not. Several are of special interest. The 1955-1956 inauguration of secondary reserves, which was achieved over the objections of the chartered banks, is still in effect. (One may wonder whether the agreement should not be terminated.) Another is the

(1) Report of the Governor of the Bank of Canada to the Minister of Finance for 1955, pages 17-18. See Exhibit 36.

(2) Report of the Governor of the Bank of Canada to the Minister of Finance for 1956, pages 33-34. See Exhibit 37.

(3) Report of the Governor of the Bank of Canada to the Minister of Finance for 1956, pages 34-35. See Exhibit 38.

(4) Report of the Governor of the Bank of Canada to the Minister of Finance for 1957, page 28. See Exhibit 39.

The segregation of savings and commercial deposits was mentioned by Mr. Coyne in his 1956 Report, pages 9, 27 and 29. See Exhibit 40.

(5) Report of the Governor of the Bank of Canada to the Minister of Finance for 1959, page 37. See Exhibit 41.

(6) Honourable Donald M. Fleming, House of Commons, March 19, 1962. See Exhibit 42.

specific reference by both Mr. Towers and Mr. Coyne to chartered banks' savings deposits (as separated from commercial deposits) where, the former limited holdings of Canada bonds against them, and the latter sought to have a proportion invested in mortgages. This leaves open a possibility that, in order to influence liquidity or the yield curve, attempts may be made sometime to have, for instance, chartered banks invest a minimum amount of savings deposits in long-term Canada bonds. There are, of course, many variations of this theme which could be played for investing institutions. Aside from the temporary alleviations which moral suasion, when successful, may attain, it may in future be a proving ground, indicating the desirability and practicability, or otherwise, of legislative changes in the Acts respecting the Bank of Canada, the chartered banks, insurance companies, etc. The following matters, which in the past have interested Governors of the Bank, should perhaps be investigated thoroughly with such views in mind.

i. Should the Bank of Canada have the power to vary margin requirements on loans for carrying stocks with both chartered banks and stock exchange member houses.

ii. Should the Bank of Canada have the power to alter the terms (i.e. rates of interest, down payments, periods of repayment) governing instalment purchases through finance companies, banks, etc.

iii. Should the Bank of Canada have direct power in regulating term lending (including N.H.A. mortgages) by banks. As opposed to public sale of securities, direct term lending by banks for capital expenditures involves the creation of deposits without any offsetting reduction in savings, and hence increases the money supply for as long as the loan is outstanding. This works against flexibility in monetary policy.

iv. Should the Bank of Canada have the power of establishing and varying the cash reserves of trust companies and other "near" banks.

VII. LIMITATIONS OF MONETARY POLICY

61. It is evident that, even when the aims of fiscal and monetary policy are harmonious, there are limitations to the extent of the efficiency of monetary policy in achieving its objectives. This has been recognized by the Macmillan Commission, as well as by the three Bank of Canada Governors, the Chairman of the Board of Governors of the Federal Reserve System, and the Governor of the

Bank of England to name a few.[1] Fundamentally, it can only bring influence to bear in a general way to create an atmosphere which may be conducive to attaining the desired conditions. In other words, it cannot be particular in the sense that it can determine who will get a job and at what level of pay, who can or will borrow money and at what rate, what price an article will command, nor can it influence price levels (nor supply and demand factors) in other countries, which might lead to variations in exports and imports for a country such as Canada.

62. It may be somewhat less evident, but a central bank may well have conflict from its own functions in attaining its own objectives. In the case of the Bank of Canada, this has been true. For example, in periods when it has been attempting to stimulate the economy by easing credit, it has had to sell bonds for Government accounts such as the Unemployment Insurance Fund. In periods of credit restraint, when the public and the chartered banks have been sellers of government bonds, (sometimes the public redeem their Savings Bonds, and this could reach embarrassing proportions in times of stress) it has had to support the market in order to avoid chaotic conditions. It has also felt compelled to stabilize the bond market before, during, and/or after, government financing. Even in its capacity of lender of last resort, it has had to extend credit temporarily, when it wished to be restrictive. Furthermore, whether ease or restraint is indicated, foreign exchange stabilization or undesirable flows of foreign credit have impinged on the effectiveness of desired policy and, of course,

(1) See Exhibit 43, for:

- Macmillan Report - paragraph 235.
- The Standing Committee on Banking and Commerce, Mr. Towers' Hearings, 1939 and March 23, 1954.
- Mr. Coyne, on whom the first protracted period of restrictive policy fell, had the most to say. The quoted comments are from his 1956 Report, pages 23-25, and the 1957 Report, pages 17-18. His comments in the 1959 and 1960 Reports are lengthy. See pages 3-10, and 16-23, respectively. His public speeches in these years are also illuminating.
- Mr. Louis Rasminsky - comments made in a press release, dated July 31, 1961, shortly after his appointment as Governor of the Bank of Canada, and in his Report to the Minister of Finance for 1961.
- Federal Reserve Bank of Philadelphia, "Quest for Stability", pages 36 and 52.
- Remarks by Wm. McC. Martin before the Association of Reserve City Bankers, April 11, 1961.
- Remarks by Lord Cobbold, Edinburgh, February, 1961.

mysterious changes in the velocity of circulation have upset carefully calculated projections. However, the Bank has, generally speaking, been ingenious in its use of offsetting action and/or moral suasion under these and other circumstances. Indeed, discounting the probability which always exists for human error, it is only in recent years when fiscal policy involving continuing deficits and high taxation has taken precedence over monetary policy, that Bank action has become somewhat ineffective. Perhaps, the framers of fiscal policy should examine the oft-quoted preamble to the Bank of Canada Act, and govern themselves accordingly. In support of this last statement is the testimony of Mr. Towers before the Standing Committee on Banking and Commerce in 1939.[1] The following excerpts are still applicable, even though the hearings were held some 23 years ago: "My first comment would be that most advocates of compensatory deficit spending have developed their theory with tacit reference to countries which to a far greater extent than Canada, produce for internal consumption.

63. "Canadian thinking on this problem is inevitably influenced by developments in theory and practice which are taking place in the United States. In that country only about one-twentieth of the national income consists of receipts from goods and services sold abroad. In Canada, the proportion is about one-third. In the United States the problem of achieving full employment and production is mainly one of offsetting or compensating for a reduction in the private demand for durable goods. No one would attempt to deny the existence of a comparable problem in Canada; just because our growth through the later twenties was so rapid the drop in private demand for durable goods has been all the more severe. But in Canada there is superimposed upon this a problem which is perhaps more important and certainly more difficult, viz., what to do about a reduction in the demand for goods and services which we sell abroad.

64. "Deficit spending in Canada can have little direct influence upon the course of foreign demand for our products. It can do little to increase domestic consumption of things which we normally export. Again, because of the specialized character of the production for which Canada is suited and equipped, it is unusually difficult to meet a decline in foreign demand by creating domestic de-

(1) Memoranda and Tables re Bank of Canada given before the Standing Committee on Banking and Commerce, Chapter V - pages 47-50. Readers will find that little up-dating is necessary.

Mr. Coyne expressed much the same thought in a speech entitled, "Sound Money for Sound Growth" given on March 22, 1960. See Exhibit 44.

mand for new things which this country can produce at a reasonable cost. And the necessary shifts of man-power and equipment might be definitely wasteful if the fall in export demand turned out to have been only of short duration.

65. "There are, therefore, greater limitations upon what compensatory deficit spending can do to offset fluctuations in the Canadian economy than there would be in the case of a more diversified and self-sustaining country. There are also greater dangers involved, as I shall now indicate.

66. "An export economy is in the position of having very little influence over the level at which many of its most important prices are set. It should, therefore, do all it reasonably can to keep its costs flexible and to avoid introducing elements of rigidity through borrowings on fixed terms. Otherwise its competitive position in foreign markets may be adversely affected.

67. "I have already indicated why I think compensatory spending is likely to have less influence upon the course of real national income in this country than it would in most others. When large government expenditures are being made and debts are mounting rapidly, there will presumably be relatively less to show for them in the way of an immediate expansion of activity, and the possibility of harmful reactions upon private confidence and spending will be relatively greater."

68. "The apprehension which large government deficits may arouse in the minds of business men and investors, even if it happens to be initially ill-founded, is none the less real. If it is sufficiently strong it tends to bring about its own realization, and is accordingly a factor which warrants most careful consideration when deciding upon fiscal policy.

69. "Another of the main arguments advanced by opponents of a compensatory deficit policy is that it may lead to inflation. In the case of a largely self-contained economy general inflation is unlikely to occur so long as appreciable reserves of productive capacity remain in idleness. In the case of Canada, however, one must also take account of the fact that, under present conditions, there are fairly definite limitations upon the range over which domestic production can compete with imports on a cost basis. At least part of the active spending power created by government deficits is likely to increase imports rather than give work to unemployed Canadian men or machines. If the increase in imports is not offset by increased exports (or by borrowing abroad) the external value of the Canadian dollar will tend to fall and Canadian prices will tend

to rise. In other words the mere existence in Canada of large amounts of unused capacity does not in itself preclude an inflationary rise in prices."

70. Mr. Towers, in one of his rare public addresses recently stated:(1) "......The fact that per capita Gross National Product is less in real terms than it was five years ago, combined with unemployment that has persisted at too high a level, should inspire a most serious and objective search for the reasons behind this unsatisfactory situation......

71. "In searching for reasons to explain Canada's unsatisfactory economic performance during the last five years, I have mentioned the international over-supply situation confronting many of our major extractive industries and the possibility that the overall burden of taxation and an over-valued currency have had a depressing effect on our affairs. All these things have a bearing on our costs and prices. There is the further possibility---indeed probability---that other factors have been operating to push our costs out of line with the rest of the world's. Wage rates are not the only factor in costs of production but they are a very important one, and, if increases in rates are in excess of increases in the productivity of labour, the end result is unemployment, balance of payments difficulties or both......

72. "......international conditions have been changing rapidly since 1956 and we have to compete with a number of major countries which, so far at least, appear to have had relative success in keeping their costs of production in line. When this situation gives rise to unused capacity and unemployment in the higher cost countries, attempts to stimulate the economy by public spending and monetary expansion can hardly be regarded as effective long-term solutions."

73. Confirming Mr. Towers' thoughts (but referring to the United States) is the following extract from the highly respected monthly letter of the First National City Bank for November, 1961. "......there is a "mysterious tag" on government dollars. It says right on our coins and paper money that they are issued by the authority of government. Government spending can be financed by monetary inflation, by use of sovereign powers of money issue. Private spending, under the discipline of income flow and creditworthiness, lacks power to create inflation of truly "explosive" dimensions. Government has unique power to increase spending, and not only through money issue but also through taxation......It may be observed that an in-

(1) Address, on January 25th, 1962, to the Annual Meeting of The Canada Life Assurance Company, in his capacity as Chairman of the Board.

creasing proportion of federal expenditures is in welfare categories where there are no goods produced or services provided as a counterpart for the income given. These payments, however great their social merits, subtract from needs to work, from production, and from flows of goods and services in the markets.......Then there is the influence of the extreme rates of taxation, justified by the demand of government for more money to spend. Concentrated on working people as a class, they subtract from human effort and from the ability of the private business system--which puts the goods on the shelves of the stores--to finance innovations which lower production costs and prices.......Although there is a view that rising curves of government spending can stimulate economic growth, the evidence points to the contrary conclusion: over-rapid growth of government spending and taxing obstructs balanced growth of the whole economy. The only time in the past decade that business fixed investment moved up to a higher plateau was in 1956-57, after the 1954 cutbacks in government spending and taxes.......Thus, through the tax system used to raise them, government dollars obstruct progress and hence the flows of goods in the market that give real value to money."

74. Observers of the Canadian economic scene will be well aware that text books and tradition throw little light on the problem of continuing budgetary and cash deficits which have become the pattern here, regardless of contraction or expansion in the nation's economy, and despite stifling levels of taxation. Government embarked on an enlarged spending program and broader welfare payments a few years ago, presumably to alleviate unemployment problems. Evidence of success from this policy is inconclusive. In the meantime, the atmosphere which has been created is one of apprehension and concern, hardly the basis for broad economic development. It is urgent that the present government (and those to follow) return to fiscal orthodoxy and take steps to move toward cyclically balanced budgets, thus bringing fiscal and monetary policies together harmoniously.

VIII. RECOMMENDATIONS AND SUGGESTIONS

Reference

75. In the above text, recommendations have been made and suggestions advanced which involve further discussion before arriving at definite conclusions. Perhaps, the most important matter discussed is the Canadian
para. 62-74 Government's fiscal policy which has involved continuing deficits and
Exhibit 44 stifling rates of taxation, but does not appear to have been particularly effective in stimulating the economy to the point where full use can be

made of excess plant capacity and labour supply. Such a policy tends to create import demand, put strains on exchange rates, and creates distrust of the intrinsic value of the currency both internally and internationally and may lead, ultimately, to disruption of savings and investment programs. It has made monetary policy and the central bank quite ineffective. It is of prime importance that a more appropriate fiscal policy be developed in Canada.

76. Other recommendations are summarized in the following paragraphs. They appear, more or less, in the order in which they have been discussed in the text above, and no attempt has been made to present them in order of importance.

77. Amendments should be made to the Bank of Canada Act clarifying the Bank's relationship with the Government. Procedure to be followed in the event of the resignation of the Governor, either by his own volition or by request, should be established.

para. 7
Exhibit 4

78. In order to eliminate a serious conflict of interest position, debt management should revert to the Department of Finance, from the Bank of Canada. The Department should regularly make use of advisory committees from the dealers and banks. The number of primary distributors used in government financing should be reduced, and include only those who normally position government securities and who regularly make markets.

para. 8-13
Exhibits 5-7

79. In an endeavour to restore confidence in and broaden the mid and long-term segments of the government market, consideration might be given as to whether selected dealers should obtain "lender of last resort" facilities, from the Bank of Canada, against collateral of government bonds maturing in more than three years with special flexible call loan facilities at chartered banks. Less emphasis should be placed on Canada Savings Bonds as a means of Government financing. Basically, they should be available as a means of saving, rather than a medium for the investment of funds already saved.

para. 16
para. 9 (v)

80. The Bank of Canada's research department should make available informative pamphlets, which would clarify the Bank's functions, actions and intentions, to complement available statistical material.

para. 17
Exhibit 11

81. The Bank of Canada's Board of Directors should be strengthened, and from time to time, the Bank should make use of advisory committees to be selected from dealers and banks.

para. 18-19
Exhibit 12

82. The Bank of Canada's open-market operations should be confined to securities in the money market range of three years and under and, when possible, emphasis should be on operations in the bill market. The only exception should be in the event of a disorderly market situation, or when operations are for some Government account.

para. 21-28 & 35
Exhibits 13-19

83. The Bank of Canada's trading departments in Toronto and Montreal should be enlarged and traders given more authority, in order to facilitate trading and to enable the Bank to have a better feel of the market. Normally, the Bank's trading should be limited to those organizations which regularly make markets in government securities.

para. 29-30
Exhibit 20

84. There should be a complete examination of the Government's exchange policy. Among other things, Canada's position vis-a-vis The International Monetary Fund should be clarified, decisions should be reached concerning the adequacy, or otherwise, of our exchange reserves and holdings of gold, and conclusions should be made as to the desirability, or otherwise, of the Canadian dollar being "pegged" in relation to other currencies.

para. 36-37
Exhibits 22-23

85. The Bank of Canada's discount rate should cease to "float" ¼% above weekly treasury bill awards, and become administered. Changes in rate, when deemed necessary, should be accompanied by an explanatory statement by the Governor of the Bank, and on occasion, supported by a statement from the Minister of Finance.

para. 41-43
Exhibits 28-30

86. Other matters have been mentioned, but further examination and discussion seems to be indicated before recommendations can be made. These suggestions are outlined in the following paragraphs.

87. The Commission might consider whether, if the Department of Finance assumes the debt management function, it would be desirable for dealer syndicates to underwrite direct and/or guaranteed (e.g. CNR) financing.

para. 13
Exhibit 7

88. The Commission might examine whether chartered bank secondary reserves, which were instituted through moral suasion in 1956, should continue to remain in effect.

para. 40 & 60
Exhibits 26-27

89. The use of "moral suasion" by the Bank of Canada has been quite extensive, and information gained in its application might be examined to see whether the Bank of Canada should have additional powers to influence such items as stock margins, terms relative to instalment sales, term lending by chartered banks, and reserves for "near" banks.

para. 44-60
Exhibits 31-42

EXHIBITS

Exhibit 1. Macmillan Report

219. The functions discharged by a central bank being of such vital importance to the economic and financial life of a country, it is perhaps natural to ask whether they could not be adequately performed by some direct organ of government. It has in practice been found that a central bank can give most effective service to the community if it is free from the fear of interference for political ends in operating the delicate mechanism of the national monetary and financial machine.......it has been found that there are pre-eminent advantages to the state in entrusting the special and highly technical functions of a central bank to a body not subject to the vicissitudes of political life.

Exhibit 2. Macmillan Report

206. ...., the central bank,......., should endeavour to regulate credit and currency in the best interests of the economic life of the nation and should so far as possible control and defend the external value of the national monetary unit. ...., from the international point of view, the central bank by wise and timely co-operation with similar institutions in other countries, should seek, so far as may lie within the scope of monetary action, to mitigate by its influence fluctuations in the general level of economic activity. These functions do not, of course, exhaust the tasks of a central bank. Within a state, the central bank should, in addition, be a ready source of skilled and impartial financial advice at the disposal of the administration of the day.......

207. It is easily possible to expect either too much or too little of central bank action. A central bank is at the same time an instrument and a force. As an instrument it is the means by which the state--which must necessarily retain ultimate sovereignty in matters affecting the currency--can give effect to the national policy. As a force the central bank has certain powers in its keeping which can be used to achieve the ends of national policy. Clearly these powers are of differing efficacy according to the aim of the policy. A central bank cannot be expected to influence the price of a particular commodity. It is even not desirable that a central bank should be specifically charged with any responsibility for the general price level of a country. There are many factors, of varying nature, which combine to influence that level and a central bank, working as it does purely in the monetary sphere, cannot be expected to have complete control, though it may well have a measure of influence. If it attempted to exercise any drastic control it would have to wield powers far beyond those which any body other than the sovereign authority would be entitled to exercise. It is manifest, however, that the regulation of the volume of credit is an important factor, in influencing the level of economic activity and therefore of prices and this is one of the cardinal tasks of a central bank........ The regulation of the quantity of credit is effected by the action of the central bank on the reserves of the commercial banks. By increasing or diminishing these reserves, or by increasing the cost of securing them, there is set in motion a process of expansion or contraction through the ordinary channels of banking.........

208. In the control over the external value of the monetary unit the action of the central bank is also of major importance. This function, indeed, is a logical outcome of that of credit regulation. Whatever additional influences may affect the level of the exchanges, such as short term capital movements, external borrowings and indebtedness, and the income from overseas investments, the long term factor of decisive importance is the credit structure of the country, and no modern state can afford to dispense with the

most effective controlling instruments.

209. The services which a central bank may perform in the international sphere are even less easily dispensed with in the modern world than those which it can render within the borders of a state. Whatever changes may occur in the volume of international trade and the comparative positions of various countries, there has never been a time when external financial inter-relationships have assumed more importance than in the last decade.......

210. The precise degree to which the level of economic activity in the world as a whole may be influenced by concerted international monetary action, may be a matter of opinion, but that a common direction in monetary policy may have an important influence in avoiding economic excesses or in stimulating revival is beyond dispute. The co-operation of central banks is beset with many difficulties; its effects are limited or distorted by many non-monetary influences; but if we wish to continue that mutual interchange of goods and services which in the past has stimulated the economic life of all parts of the world, we ought to use all possible means of bringing order into the realm of international relations. In the monetary sphere the germ of such order is to be found in the inter-relations of central banks working to harmonize national policy with the needs of the international situation.

218. To enable it to discharge the essential functions to which we have referred above, modern experience tends to show that certain definite principles should be observed in the constitution of a central bank. Thus, in order that it may regulate credit and currency, it is essential that the central bank should hold a suitable proportion of the cash reserves of the commercial banks. It is essential for the full and satisfactory working of a central bank, that it should have the sole right of issue of legal tender notes; it is essential that the central bank, as the financial adviser of the Government, should in due course hold the various Government accounts and carry out, on behalf of the Government, all major financial transactions.

229. ....It may indeed be the case that in the absence of a highly developed money market the control of a central bank in Canada over the financial system could not be as sensitive as that which is exercised, for instance, by the Bank of England in the United Kingdom. The fact, however, that a new institution in Canada would not be able to employ all the instruments of control exercised in an older and financially more highly developed country, seems to us an inadequate reason for omitting to develop such control as could undoubtedly be achieved. The financial system and economic life of Canada are already sufficiently well developed to make the instruments of the discount rate, the purchase and sale of securities, and operations in the foreign exchange market, of sufficient importance in the hands of a well-managed central bank to give it a decisive influence on the credit situation in Canada.

230. Canada is a country with a relatively large volume of external trade and a heavy external indebtedness and is, therefore, especially interested in the international value of her currency. The holding of gold and foreign exchange by the central bank should and could become a factor of the first importance in carrying out the national policy in regard to the external value of the currency. It is no part of the functions of a central bank to monopolize the exchange markets. Here, as in the case of credit control, its function is to impart or counteract a trend as circumstances require, and this task, even from an early date, would be within the capacity of a Canadian central bank.

Exhibit 3. G. F. Towers' 1st Report

The functions of a central bank are well set forth in the report of the Royal Commission on Banking and Currency in Canada. The chief functions are to endeavour to regulate the volume of credit; to defend the external value of the national monetary unit; to be a ready source of skilled and impartial advice at the disposal of the Government (in the case of Canada, the Dominion and Provincial Governments); and to afford timely co-operation with the central banks of other countires......

Exhibit 4. Hon. J. L. Ilsley-House of Commons 1941

.......the Bank of Canada was created by parliament as an autonomous corporation with its stock owned wholly by the government, but with its own management and board of directors appointed by the government. It is an arm of the government, but not a department of the government. The character of the act is such that responsibility for its operations is placed squarely on the shoulders of the governor and the board of directors....... The point which I would like to emphasize is that the responsibility with which the governor and board have been charged by parliament does not in any way relieve the government of the responsibility for the monetary policy being pursued by the Bank, nor in any way militate against public control of monetary policy. The monetary policy which the bank carries out from time to time must be the government's monetary policy, but the government must leave the carrying out of that policy, the choice of ways and means of executing it, to the management of the bank in whose judgment it has confidence.
If the government is satisfied with the policy which is being pursued, there is obviously no quarrel between it and the bank. Let us suppose, however, that the management of the bank and the government do not see eye to eye in the matter of monetary policy.......In such a case there can be no question whatever as to the outcome of the dispute. The government's view will prevail.
In view of the statutory responsibility placed on the governor and the board of directors, I do not believe that those of them who disagreed with the government on a fundamental issue could conscientiously carry out the government's policy. It would therefore be necessary for them to resign, and they would be replaced by others who were willing to accept responsibility for the type of policy which the government believed to be appropriate.

G. F. Towers- House of Commons, 1954.

.......The situation is that parliament has placed squarely on the shoulders of the directors and management of the Bank of Canada the responsibility for monetary policy. It would be of no use for us to come before a committee of this kind and say in respect of certain actions which were criticized, we did not like that but the government wanted us to do it.......We must and do take full responsibility for everything which we have done.......There is no alibi possible for the central bank. On the other hand, there is no alibi possible for the government, because if government said: well, we disagreed with what the central bank did, but parliament has placed the responsibility on them, so what could we do? the answer obviously is that the administration of the day, supported by a majority in parliament, can always alter the legislation. In fact, I doubt whether a disagreement would ever necessitate such a thing, because there are various ways and means by which directors and management can be got rid of.......There is a long history behind this thing in central banking.......Just to make sure that nothing I have said conveys a misunderstanding, I would like to add that no central bank, and certainly not the Bank of Canada has any delusions of grandeur or any thought that it has sovereign power that always lies with the administration which commands a majority in Parliament.

J. E. Coyne- House of Commons, 1956.

.......if the government of the day were sufficiently displeased with the bank or the management of the bank, they could put in motion steps which would bring about a change in the management. At some stage in that process, if the government were so determined as to make a real issue of it, a public issue presumably, the governor would have to resign.......I do not think it follows from that--I am sure Mr. Towers did not mean it to follow from that,--that because the government can bring about the removal of the governor of the bank, therefore, the governor of the bank must do whatever the government wants him to do. Nor does it follow in fact that the government expresses views of a kind that would require action by the bank contrary to its own views of what should be the appropriate monetary policy at that time. Certainly parliament is supreme, and the government, having a majority in parliament, is in a position, if it thinks strongly enough about a matter, to bring about a change in the management of the bank.......

Louis Rasminsky- July 31, 1961 Statement.

I believe that it is essential that the responsibilities in relation to monetary policy should be clarified in the public mind and in the legislation. I do not suggest a precise formula but have in mind two main principles to be established: (1) in the ordinary course of events, the Bank has the responsibility for monetary policy, and (2) if the Government disapproves of the monetary policy being carried out by the Bank it has the right and the responsibility to direct the Bank as to the policy which the Bank is to carry out.

The first principle is designed to ensure that the Bank has the degree of independence and responsibility necessary if it is, in the language of the Bank of Canada Act, "to regulate credit and currency in the best interests of the economic life of the nation". To discharge this duty the Bank must be sufficiently independent and responsible in its operations to be able to withstand day-to-day pressures from any source. But in the longer run, if there should develop a serious and persistent conflict between the views of the central bank with regard to monetary policy which, after prolonged and conscientious efforts on both sides, cannot be resolved, the Government should be able formally to instruct the Bank what monetary policy it wishes carried out and the Bank should have the duty to comply with these instructions. The exercise of this authority by Government would place on Government direct responsibility for the monetary policy to be followed. If this policy, as communicated to the Bank, was one which the Governor felt he could not in good conscience carry out, his duty would be to resign and to make way for someone who took a different view.

<u>Exhibit 5.</u> G. F. Towers 1938 Report

Acting under powers conferred by section 23 (2) of the Bank of Canada Act, you required the Bank, as from April 1st, 1938, to act as Agent for the Government in the payment of interest and principal and generally in respect to the management of the public debt of Canada. The Public Debt Division of the Bank was constituted for this purpose. and on April 1st last the staff of the Loans and Interest Branch of the Department of Finance entered our service. In view of the fact that so much of the work of the former Loans and Interest Branch had been interwoven with work performed by the Bank in its capacity as fiscal agent of the Dominion Government, we believe that the amalgamation will be in the interest of efficiency and economical operation.

Exhibit 6. R. V. Roosa- Federal Reserve Operations.

Most of the bidders for small amounts, and many others up to the limit of $200,000 per subscriber, submit noncompetitive tenders which are allotted in full at the average price determined by the accepted competitive tenders (about one sixth to one eighth of the total bill issue each week is currently accounted for by the noncompetitive tenders).

Exhibit 7.

For many years, government-guaranteed C.N.R. financing was handled in this way. When it was taken over by the Bank of Canada in 1951, Mr. Donald Gordon, the Railway's President and formerly a deputy governor of the Bank, expressed his regrets to the Syndicate managers and commended them for their efforts in the past. It may be completely without significance, but in the past three or four years, C.N.R. financing has caused not a little disturbance to the bond market. Mr. J. E. Coyne in a speech entitled, "Credit and Capital" made on December 14, 1959, stated, in part: ".......What is perhaps not so widely recognized is that we also have in Canada a well developed nation-wide capital market, particularly in respect of the distribution of securities issued by governments, local authorities and business corporations. This is primarily the field of activity of investment dealers. I think there is little doubt that the financial machinery existing in Canada for the placing of new issues of securities on the market is the equal of that of any country in the world and, in proportion to our size, it probably arranges, year in and year out, for the provision of a greater quantity of new capital to those requiring it than is the case in any other country in the world. The results achieved are a reflection of the industry and enterprise and broad national outlook of our investment dealers,......."

Exhibit 8. G. F. Towers- 1953 Report

A broad and active demand for short-term government securities is an essential feature of an effectively functioning money market. The Bank of Canada has always endeavoured to encourage the growth of a short-term market in this country and several further steps in this direction were taken during 1953. The Government of Canada changed its regular offers of treasury bills from a fortnightly to a weekly basis and made available 273-day bills in addition to the usual 91-day bills, both of which developments found favour with the market and increased the demand for and turnover of such securities. In the year just past the Bank of Canada instituted purchase and resale agreements with bond dealers who take a jobbing position in the short-term Government of Canada market. Under these arrangements a dealer may within agreed limits sell treasury bills and short-term Government of Canada bonds to the Bank of Canada with an undertaking to repurchase them over a short period at a predetermined yield to the Bank.

These arrangements offer jobbers an alternative method of financing inventories of such securities so that they are at all times able to meet the requirements of their customers, including other bond dealers who only occasionally have transactions in short term securities.......

Exhibit 9. G. F. Towers- House of Commons, 1954.

The term "money market" is widely used but seldom defined and indeed it is not easy to give it a precise definition. The particular sector of the overall financial market which it describes has varied from country to country and from time to time. I think a

general definition would include any markets for financial assets in which individuals, corporations and financial institutions invest their short-term funds, and in which a certain amount of turnover, or buying and selling, goes on fairly continuously. It is a market for the temporary employment of cash balances.

In Canada, Treasury Bills and other Government of Canada short-term securities are by far the most important categories of assets involved at the present time. Commercial bills and similar instruments which are an important factor in the money market in London, for example, have played and are likely to play a negligible role in Canada. In this country they are held exclusively by banks and there is no trading even between banks in this type of paper. There are a number of other types of securities or assets which may be said to be actually or potentially on the fringes of the money market. For example, the larger provincial governments have a substantial volume of short-term debt outstanding, some of it bearing the name of Treasury Bills. At present there is no trading in these Bills and they are in reality just another form of short-term loan to a province by its banker or bankers. They might, however, develop sufficient tradeability in future to be classed as money market paper. Again, while there is no call loan market in Canada dealing in loans which can be called on really short notice and which are made on an impersonal basis, the type of bank loan which stockbrokers and investment dealers presently use to finance their inventories might in future develop in the direction of being a true money market type of asset.

I would not include in my definition of the money market such specialized markets as the stock exchanges and the foreign exchange market owing to the fact that it is not their primary function to provide a liquid form of asset for the investment of short-term balances. For practical purposes then, the Canadian money market consists at the present time of all the buyers and sellers of Treasury Bills and other short-term Government of Canada securities. This will always be the core of the Canadian money market, and only as breadth and volume is developed in this area is it likely that the boundaries of the money market can be extended as widely as in larger and older financial communities.

Now I would like to say a few words about the functions of the money market. In general, I believe that one can say that its function is basically the same as that of any market in a competitive economy whether it deals in financial or physical assets. A good market, by promoting wide competition between sellers and providing wide choices to users, tends to distribute resources where they are used with maximum efficiency. Short-term capital, like any other commodity or service, is likley to be forthcoming in optimum amounts and to be most efficiently used if it is subject to the incentives and disciplines which are provided by a broad market. In Canada, where I think we can look forward to rapid growth and a correspondingly large demand for capital, and where there is considerable scope for Canadian capital to displace external sources of financing, we clearly need to use our own sources of short-term as well as long-term capital as effectively as possible. Moreover, the kind of financial machinery needed to provide a good short-term Government securities market will also help to provide better facilities for long-term financing.

Exhibit 10. J. E. Coyne- 1954 Report

The introduction in mid-June of what are known as day-to-day loans was an important development affecting both banking practices and the short-term securities market or "money market". These loans are made by chartered banks against the pledge of treasury bills and Government of Canada bonds maturing within three years. The borrowers are

those bond dealers who are prepared to act as jobbers in the short-term market and who have entered into purchase and resale arrangements with the Bank of Canada. Day-to-day loans may be called for payment at any time and the willingness of the Bank of Canada to purchase securities under resale agreements provides an underlying assurance of liquidity.

From January 1953 to June 1954 the Bank of Canada had made a considerable amount of funds available for the financing of dealers' inventories of treasury bills and short-term Government bonds through purchase and resale agreements. The total provided in this way reached a maximum of $73 million in June. Subsequently, day-to-day loans from the chartered banks provided this financing in amounts which, as at the close of business on Wednesdays, varied between a low of $44 million and a high of $135 million, and Bank of Canada facilities were infrequently used.

In addition to providing a source of funds to finance dealers' inventories of short-term Government securities, day-to-day loans afford a convenient and efficient means whereby the chartered banks may adjust surplus or inadequate cash reserve positions. A bank desiring to replenish its cash reserves may call part or all of its day-to-day loans and present the borrower's cheque through the Clearing House for credit to its account with the Bank of Canada the following day.** When the day-to-day loan rate is below the Bank Rate, as has consistently been the case, the borrower whose loan is called has a strong incentive to obtain the funds required to repay the loan from another chartered bank which has surplus cash, rather than from the Bank of Canada under a purchase and resale agreement. One of the effects of the call and the new loan is to transfer deposits at the Bank of Canada from the lending to the calling bank. If the borrower is not successful in obtaining a day-to-day loan from another bank and obtains the funds from the Bank of Canada, the initial effect is to increase the total cash reserves available in the system, as the calling bank receives an addition to its cash without a corresponding decrease in any other bank's cash.

** A bank can obtain additional cash on the same day by borrowing from the Bank of Canada. In the case of sales of treasury bills, Government of Canada bonds maturing within 5 years, and longer-term Government of Canada bonds, market practices respecting delivery and payment dates have the result that cash is received on the second, third and fourth days, respectively, after the day of the sale.

Exhibit 11. Radcliffe Report

862. We have one other object in view. This is to strengthen further the research and intelligence side of the Bank's activities and so to assist the Bank to take the lead in promoting and inspiring the objective study of monetary and financial problems. The total volume of research that has been done upon them up to now inside and outside the Bank, appears to us to be insufficient. Moreover the additional information that we suggest should be collected will require analysis by experts skilled in its interpretation and able to sift it so as to provide a more comprehensive view of the way in which the different parts of the financial system are functioning. We have suggested that there are certain areas where we are still too much in the dark and where day-to-day decisions have to be taken with only a limited perception of the relevant factors. An increase in the flow of information will help to remedy this; but it will do so more effectively if the information is made the subject of study and research inside the Bank.

Exhibit 13. Macmillan Report

227.....Here we should say at once how strongly we endorse the remarks made in a memorandum of the Canadian Bankers' Association, regarding the vital importance to such an institution of the quality of the governors and directorate. Experience, skill and integrity are required in the highest degree, and that, not only to ensure that the operations of the Bank shall be wisely conducted, but also that the institution should win and maintain the confidence alike of the government, the people and the commercial banks.

Exhibit 13. G. F. Towers- House of Commons, 1954.

As part of our programme to improve and broaden the money market for the benefit of lenders and borrowers and of our financial structure as a whole, the Bank of Canada has been a constant trader in government of Canada securities since we opened our doors in 1935. While the total amount of our holdings of government securities is necessarily determined by considerations of monetary policy, we have endeavoured to help make a market for all government issues and have been very substantial buyers and sellers. In a sense, we perform a jobbing function, holding the inventories which are indispensable to a good market. Investment dealers and banks also operate in this way, although naturally on a smaller scale. We would be glad to see both dealers and banks extend their operations of this character, and have the Bank of Canada play a smaller part, although we would always expect to be a substantial participant in the market.

Exhibit 14. J. E. Coyne- House of Commons, 1956.

The central bank does not ordinarily take the initiative to increase or decrease the cash reserves of chartered banks. That is to say, it does not step out and bid for securities if it thinks an increase in cash reserves is desirable, or step out and offer securities in the market, if it thinks a decrease in cash reserves is desirable.

At any rate, not usually. For the most part there are transactions going on in the market all the time, People are making offers to buy or to sell, and the central bank is usually in a position to be able to respond to offers to buy from others rather than to take the initiative to make offers itself.

When there is a need for more money in the country, you probably find some people---- you are certain to find some people----are selling securities in order to raise cash. If there is a need for more money as indicated by that fact, the central bank can buy some of those securities that are being offered, and thereby provide the cash. It will probably do so at prices which progressively decline as the strength of the selling pressure keeps up, so that you will probably find rising interest rates at a time when there is a demand for more money.

The rise in interest rates, of course, would be much greater if the central bank took no action at all. If we simply stand still interest rates would rise until sufficient buyers were found among the general public to balance the sellers among the general public. So, on the other side of the picture too, when, for a lack of other opportunities to invest, people are interested in buying government securities on an increasing scale, the tendency will be for the central bank to provide some of those government securities and sell them, and in that way dampen the fluctuation, which in that case would be a rise in government security prices, and a decline in interest rates. Generally speaking the central bank tries, and I think certainly should try, to foster orderly conditions in markets, and to dampen fluctuations, but not necessarily to prevent fluctuations if they represent real changes in supply and demand.

Exhibit 15. Radcliffe Report

339. At the heart of its work as the central bank lie the Bank's open market operations in Government debt, including both operations in Treasury Bills in the course of management of the money market and operations in Government bonds for the purpose of influencing the gilt-edged market.

340. The Bank of England operates almost daily in the money market, by buying Treasury Bills from the market (thus putting cash out) or selling Treasury Bills to the market (thus taking cash in), to smooth out shortages and surpluses of funds between one day and another, which arise mainly out of the uneven incidence of payments by and into the Exchequer. The purpose of these operations is that of maintaining an orderly market....... It is in the Government's interest, as the largest borrower in the money market, that the money market should be an orderly market; and that requires that the short-term rate of interest should not fluctuate wildly from day to day or week to week but should be reasonably stable.......

373. ....If, for example, the Bank is buying Treasury Bills and selling, in equal amount, short bonds, it is maintaining unchanged the total of the debt but is inducing the private sector to hold the debt with an average maturity date further away: the private sector's total portfolio of financial assets becomes less liquid.......; while if the Bank is selling short bonds or Treasury Bills and buying long bonds, the average maturity of the debt is shortened and the private sector is becoming more liquid.

Exhibit 16. P. G. Fousek- Foreign Central Banking.

In general, the bank appears to confine its open market operations to short-term securities, although on occasion it intervenes also in the medium and long-term market. Partly because data on changes in the detailed composition of the bank's holdings are not published, it is difficult to determine the importance of the bank's longer term operations. In any event, it seems to be agreed by observers that during recent years the bank has conducted operations in longer term securities only in order to smooth out undue deviations from what the authorities have taken to be the underlying trend of securities prices.

Exhibit 17. Federal Reserve System Report, 1961.

He (Mr. Robertson) also felt that the Committee should return to its previous policy of confining operations to short-term securities. In his view (1) the operation that the Committee had launched in February 1961, including transactions in longer-term securities under the special authorization, had not been successful in raising short-term and lowering long-term rates; (2) had the operation been pushed to the point necessary to achieve what he understood to be these twin goals, its defects would now be obvious; and (3) the deleterious effects of such operations on the market for long-term securities will become more apparent when the Treasury seeks---as it sometime must---to extend the maturity structure of the Federal debt by attempting to sell long-term securities for cash or in exchange for maturing securities. Furthermore, he believed that while it was possible for the Federal Reserve to acquire longer-term securities without impeding Treasury operations in a period such as 1961, when Treasury financing was chiefly short-term, the sale of such securities would present real problems. In his view such selling action would not only absorb long-term funds from the limited supply but would also aggravate the uncertainties which already plagued the long-term market, weakening its supporting structure and attenuating its appeal to investors. He could not foresee any time, when monetary policy called for absorbing reserves, that the Federal Reserve could sell longer-term securities from its holdings without impairing the ability of the Treasury to lengthen the debt. This, he thought, would be unfortunate, in view of the real need for the Treasury to achieve a more manageable maturity distribution of the public debt. Accordingly, he believed that operations in securities beyond the short-term area should be terminated immediately.

Exhibit 18. Radcliffe Report

551. ....But their attitude has also been strongly influenced by a belief that the long-run interest of the Government as a debtor was best served by orderly markets, and that orderly markets implied abstention from disruption of ruling prices just as much as it demanded official intervention to steady a demoralized market.......A deliberate marking-down of the prices at which the Government broker was willing to sell would have been regarded in the market as arbitrary juggling with the capital values of the Government's own creditors, and this would have seriously damaged "Government credit", at the Government's expense in paying the service of the debt for many years ahead. This "damage to Government credit" would have had repercussions on foreign confidence in sterling: "I need not remind you", the Governor put it, "how closely the exchange markets and the gilt-edged market watch each other."

Exhibit 19. Quest for Stability

The objective of maintaining an orderly market for Government securities was explained more fully in 1939. The purpose was to protect the market from "violent fluctuations of a speculative, or panicky nature" such as that caused by the outbreak of hostilities in Europe. It was not, however, to "assure any given level of prices or yields for Government securities" nor to prevent "an orderly rise or fall in United States bond prices in response to changes in underlying conditions,".......Recently, there has been another shift of emphasis---the System adopting the policy that open-market operations should be used for "correcting a disorderly situation in the Government securities market," instead of maintaining an orderly market as formerly. It was felt that the latter policy might result in actions at times which would be in conflict with the over-all goal of helping to maintain economic stability.......

Exhibit 20. R. V. Roosa- Federal Reserve Operations.

Liaison with the Federal Open Market Committee,is, of course, a two-way street, and it is probably as heavily traveled as the path between any two parts of any unit of Government. The inescapable fact that the seat of National Government is in Washington, and that primary responsibility for Federal Reserve policy determination must be in the statutory Federal Open Market Committee which meets in Washington, is paralleled by the equally inescapable fact that the center of the money market and the Government securities market is in New York. The physical trading facilities and the concentration of skilled trading staffs are also there. Consequently, it has been necessary to work out an unusual variety of arrangements for maintaining continuous contact between Washington, New York, and the other Reserve Banks to assure by exchange of information and frequent consultation that the detailed execution of policy in New York is in conformity with the policy objectives developed in Washington by the Committee.

Exhibit 21. Hon. D. M. Fleming- House of Commons June 1961 Budget

The third announcement I wish to make in the field of debt management concerns the establishment of a purchase fund for the orderly retirement of government debt....... The experience of other governments and of private corporations suggests that the existence of such a fund through which purchases of securities are made can have a steadying effect on the market. Over a period of time it should contribute to a reduction of interest costs.

It has therefore been decided to establish a purchase fund to assist in the management of the public debt. Its initial size will be $100 million, to be used over the next twelve months for the purchase in the market of government of Canada mid and long term securities.

Exhibit 22. Hon. D. M. Fleming- House of Commons June 1961 Budget

I now return to the exchange rate. As I have said it is the government's intention that our import surplus of goods and services, which has been running in recent years well over a billion dollars annually, should be reduced substantially, and that this should be brought about through an appropriate adjustment of the exchange rate rather than by direct government controls or subsidies, quotas or tariffs.

No one can say today what the appropriate level of our exchange rate would be when our balance of payments is in a position better suited to our present economic circumstances. But the rate will certainly be lower than it has been of late, and it may well be appropriate for it to move to a significant discount. It will be government policy to facilitate such a movement.

Accordingly the exchange fund will be prepared, as and when necessary, to add substantial amounts to its holdings of United States dollars through purchases in the exchange market. This would have the effect of increasing the foreign exchange reserves available to Canada to be used in case of need. As many competent observers have pointed out, these reserves have not grown over the past decade in line with Canada's international transactions. Once an exchange rate more closely in line with Canada's economic position is achieved, the government will use the resources of the exchange fund to ensure that the rate is kept within a range appropriate to Canada's changing economic situation.......

Exhibit 23. W. E. McLaughlin, 1962.

From September, 1950, to December 1960, Canada had a true floating exchange rate, in the sense that, aside from smoothing operations through the Exchange Fund Account, its value was determined entirely by demand and supply in the market.

From the "baby budget" of December 20, 1960 to June 20, 1961, this true floating rate was abandoned in favour of what we might call a nudged floating rate. There was no announcement of a change in policy but the Exchange Fund did exert downward pressure on the Canadian dollar through the purchase of U.S. dollars in the open market.

With the final budget, brought down on June 20, 1961, a third variety of floating rate appeared with the announcement that in the Government's view the rate should move to a "significant discount"; but there was no definition of the term "significant" and no clear indication, therefore, of the amount of discount that would be regarded as satisfactory. The uncertainty created by this announcement thinned out both sides of the market and the net result was that the Canadian dollar settled to a discount position without initially requiring active intervention by the Exchange Fund.

However, since that time the Government has, through public announcement or use of the Exchange Fund, actively intervened in the market whenever it has chosen to do so, and the nudged floating rate has clearly given way to a manipulated floating rate.

Hon. Donald M. Fleming, House of Commons, April 1962 Budget.

Since 1950 the Government, using the Exchange Fund which was set up in 1935, has operated to restrain and smooth out the more rapid movements of the rate in one direction or the other. At no time, throughout the whole period, have the resources of the Exchange Fund been used aggressively, to push the rate in one direction or the other against market forces.......

The Government has not hesitated, and will not hesitate in the future, to deploy a substantial volume of funds, on one side of the market or the other, in order to prevent sudden or erratic movements in our exchange rate.

R. V. Roosa, 1962 Speech.

.......whether a country formally adheres to the gold standard or not, it must have a reserve of some kind of internationally acceptable purchasing power---either gold, or dollars, or possibly pounds sterling, or an equally usable quick line of credit. Whenever its current receipts from sales or the inflow of capital do not equal its current outpayments, it has to draw on this reserve. Consequently, the size and ready usability of the reserve---together with the quick claims against it---must be watched continually as an indication of changes in each country's external economic strength or weakness.

No country can pursue policies indefinitely which consume its external reserves and draw down its potential credit abroad.

.......a fixed link must be preserved between gold---the universal monetary metal of timeless acceptability---and at least one national currency. Since the mid-thirties, the dollar alone has served that function. It is essential that the United States continue freely buying gold, and selling it to the monetary authorities of the world, at the price of $35 per fine ounce.......all leading countries (must) maintain fixed (rather than variable) rates of exchange in relation to the dollar, with narrow permissible spreads around the declared par value---such as the 1 per cent, each way, established by the International Monetary Fund. There must be room for market forces to demonstrate, through small changes within such a band, whether a given currency is presently strengthening or weakening. But there must not be an escape hatch through which one country or another can seek temporary refuge from balance-of-payments disciplines by juggling its own exchange rate---beggaring its neighbours and disrupting the orderly process of cost and price adjustment among the various products and services that are required for eventual balance-of-payments equilibrium.

<u>Exhibit 24.</u> Bank Reserves

The preoccupation by the banking community with changes in reserve requirement percentages in recent years has tended to obscure the primary function of the required reserve in the regulation of bank credit and the money supply. This dominant function is to provide a fulcrum on which a flexible monetary policy can get leverage and effectiveness. Since a specific volume of reserves must be held by member banks against their deposit liabilities, the Federal Reserve System, by selling Government securities, can absorb banks' excess or marginal reserves, which are available as the basis for credit expansion, or can force member banks to borrow to maintain their required reserves. Thus the System can influence the banks' ability and willingness to extend additional credit. Similarly, by buying Government securities the System can provide the banks with funds with which to repay their indebtedness or to accumulate free reserves, on the basis of which they can make additional loans or investments.

Exhibit 25. G. F. Towers- House of Commons, 1954.

There is a risk that the central bank will use that power as a crutch with which to obviate or perhaps postpone the broader action in the field of monetary policy which would really be appropriate.......But I believe that if it used those powers to supplement its other actions.......the power can be very useful, provided it is carefully used and seldom used and never simply as a crutch.......I would hope that the power......... would only be exercised at a time of sudden need and that as quickly as possible after that we would get back to the 8% ratio.......I think that the main purpose would be to hold the level in a substantial inflationary spurt without having to rely completely and suddenly on activities in the securities market.

Exhibit 26. J. E. Coyne- 1955 Report

In the course of discussions with the chartered banks in November and December the Bank of Canada urged the adoption of a standard practice regarding the maintenance of a minimum ratio of liquid assets (cash, day-to-day loans and treasury bills) to deposits. The purpose of this suggestion was to establish a working principle of bank operations which would help the central bank in the task of restraining inflationary pressures that might threaten in the future.

The function of a minimum liquid asset ratio is to increase the effectiveness of monetary policy in moderating a too rapid expansion of credit, by bringing the influence of monetary restraint to bear on the lending policies of the banks, on interest rates, and on security markets generally, earlier and more gradually and with greater certainty than would otherwise be the case.......

After discussion, the banks have agreed to work to achieve by May 31st, 1956, a mimimum liquid asset ratio of 15% which they will endeavour to maintain on a daily average basis from June on. On this basis, fluctuations above or below 15% may occur from day to day or week to week, but for the month as a whole the average would not be below the target ratio.......

Exhibit 27. James Muir- 1958

With the inception of a tighter money policy some two years ago, it was arranged between the Bank of Canada and the chartered banks that the latter would maintain a secondary reserve of 7% of Canadian deposit liabilities in day-to-day loans and Government Treasury Bills. The maintenance of secondary reserves by the banks was nothing new; the innovation lay in stating reserve requirements in terms of a positive objective.

What we have now to avoid is that this objective should become an inflexible figure. An inflexible reserve is not in fact a reserve at all but a compulsory investment.

Exhibit 28. R. V. Roosa- Federal Reserve Operations.

The use of the "discount window" by member banks is, of course, a privilege that is not to be abused or overused, since no bank should expect to exist on permanently borrowed capital beyond the equity supplied by its own shareholders........the "discount window" is not a loophole in the Federal Reserve System's credit control apparatus. It is instead a safety valve, enabling individual banks to restore their reserves to the required level when unforeseen losses of funds have created reserve deficiencies, ...In effect, borrowing gives the affected bank time both to determine whether or not fundamental changes will have to be made in its own portfolio and to carry out in a reasonably orderly manner any such changes that prove to be necessary.......

Supplementing the borrowing of the banks, which is always at the initiative of the banks themselves, and which is always granted initially (perhaps with rare exceptions, in circumstances that would have been already discussed with an offending bank), there is an entirely different method of providing funds which the Federal Reserve also may use in smoothing the gyrations of the money market---that is, the repurchase agreement with non-bank Government securities dealers. Under a repurchase agreement, the Federal Reserve acquires securities from a dealer against payment, under a contract which binds the dealer to repurchase the same securities at the same price on or before a stipulated final date, and to pay the Federal Reserve a specified rate of interest over the period that it holds the securities.

Exhibit 29. Bank of Canada Discount Rate Changes

DATE	RATE	COMMENT
March 11, 1935	$2\frac{1}{2}$%	Our bank rate was established at $2\frac{1}{2}$ per cent and remains unchanged. The figure is the same as that which was being charged for advances under the Finance Act, prior to the establishment of the Bank of Canada, and it remains the charge which we would ordinarily make to the banks for advances. It is quite out of touch with Treasury Bill rates, but this fact is not at present of any particular significance. When money is in plentiful supply, the need for loans or rediscount facilities seldom arises. It is in times of greater stringency that accommodation from the central bank is essential. A central bank must be what is known as the lender of last resort, which implies that in times of real need its rediscounting and lending facilities will be freely accorded. Reference- First Annual Meeting of the Shareholders of the Bank of Canada, February 25, 1936, page 16.
February 7, 1944	$1\frac{1}{2}$%	At a meeting of the Board of Directors on February 7th, 1944, it was decided to reduce the Bank Rate to $1\frac{1}{2}$ per cent, effective February 8th, from the $2\frac{1}{2}$ per cent level which had been maintained since the Bank's establishment in 1935. During the intervening period, there had been a considerable reduction in interest rates on short-term securities, and the Bank Rate was somewhat out of line with the current market. However, this was not a matter of great importance because the lending facilities of the Bank have been required on few occasions and for rather small amounts. The change to a $1\frac{1}{2}$ per cent rate does not mean that the Bank expects its credit facilities to be needed on a much greater scale in the future than in the past. Nor does it mean that under existing war conditions there is any less need for people to save. The utmost effort to maintain and increase our saving is still necessary, and the first and foremost concern of financial policy must be with winning the war. The stage has now come, however, when many are also having to give thought to the economic problems which will arise after the war. One factor which will affect decisions is the prospective cost of borrowing. It therefore seems appropriate that the Bank should, by reducing its Rate, signify its intention to continue the kind of monetary policy which has brought about the current level of interest rates. A policy aimed at higher interest rates would only become intelligible if, after war shortages are over, consumers' expenditure and capital development were to proceed at a rate which would overstrain our productive capacity. I see no prospect of such a situation arising in a form which would call for a policy of raising interest rates. Reference- Report of the Governor of the Bank of Canada to the Minister of Finance for 1943, pages 4-5.
October 17, 1950	2%	Effective October 17th Bank Rate was increased from $1\frac{1}{2}$ percent to 2 percent per annum. The $1\frac{1}{2}$ percent rate had been in effect from February 8th, 1944, prior to which date the rate had been $2\frac{1}{2}$ percent. The Bank issued a press release on October 16th containing the following statement: "At the time the reduction in Bank Rate took place in 1944, the Bank expressed the view that it did not then see any prospect of an economic situation in the post-war period of

a character which would call for a policy of raising interest rates. The change to a 2 percent Bank Rate is an indication that the earlier view no longer holds good under today's conditions when Canada faces the prospect of substantially increased defence expenditures adding to the pressure on the country's resources at a time of virtually full employment".

Reference- Report of the Governor of the Bank of Canada to the Minister of Finance for 1950, pages 12-13.

February 14, 1955 — 1½%

The Bank of Canada announced at the close of business today a reduction in "Bank Rate" to 1½% from the previous level of 2% which was established in October 1950. The Bank Rate is the minimum rate at which the central bank will lend for short periods to the chartered banks and the money market on the security of Treasury Bills and short-term Government bonds. Yields on these securities have declined materially over the past year and a half and Bank Rate at the old level had ceased to bear a reasonable relationship to other short-term interest rates.

In the past, Bank Rate has been changed infrequently in Canada and little use has been made of the Bank's facilities. The growth in the breadth and scale of activity in the short-term money market over the past two years has made it desirable that the Bank rate be made more flexible and bear a closer (though not fixed) relation to other short-term interest rates. The present adjustment will help to make Bank Rate a more significant factor in the money market and facilitate its more flexible use in the future as circumstances may require.

While the structure of short-term interest rates, including Bank Rate, provides an index of monetary conditions, it does not follow that every change in Bank Rate or in the level of other short rates necessarily indicates a change in general economic conditions.

Reference- Statement from the Bank of Canada, dated February 14, 1955.

August 5, 1955	2%
October 12, 1955	2¼%
November 18, 1955	2¾%
April 4, 1956	3%
August 9, 1956	3¼%
October 17, 1956	3½%

November 1, 1956 — Floating rate

Since the Bank of Canada acts in the role of lender of last resort, its lending rate should not be as low as the interest rate on the most liquid form of security in the market, namely treasury bills........Prior to November 1st, 1956 the Bank had followed the practice of keeping its lending rate above the treasury bill rate by raising the Bank Rate at intervals of some months whenever the treasury bill rate approached or temporarily exceeded the previous level of the Bank Rate. In 1956 the Bank Rate was increased from 2¾ per cent to 3 per cent on April 4th, to 3¼ per cent on August 9th and to 3½ per cent on October 17th. This procedure gave rise to some misunderstanding; in some quarters it was apparently thought that the central bank was setting or fixing or controlling interest rates of all kinds by its action in changing and publishing its own minimum lending rate.

The simplest method of ensuring that the Bank Rate will always be higher than the treasury bill rate is to keep it at some specified and published margin above the treasury bill rate, whatever the latter may be. This method was adopted on November 1st when the Bank announced that it would thereafter until further notice adjust its lending rate once a week in order to maintain it at a level of ¼ of 1 per cent above the average rate on treasury bills at the most recent tender or auction of treasury bills. At the close of the year the Bank Rate was 3.92 per cent.

Another reason for adopting the new method of determining the Bank Rate was that weekly changes in the treasury bill rate are relatively small in either direction and the fact that such changes occur weekly has become well understood. On the other hand, unexpected , unpredictable, infrequent and relatively large changes in the Bank's lending rate under the previous system were known to have a disturbing effect on business in general and on all persons who might be con-

templating the making of investments or entering into business arrangements involving credit and rates of interest. No difficulties of this sort have been reported since the adoption of the new system.

Reference- Report of the Governor of the Bank of Canada to the Minister of Finance for 1956, pages 45-46.

In his Report for 1960, Mr. Coyne, in an apparent effort to justify the continuance of the floating rate, traced the history of the Bank's discount rate and compared its use with the use made of such facilities in the United Kingdom and the United States. Pages 58-64.

Exhibit 30. James Muir- 1958.

.......I can add only that I wish Bank Rate were a more positive thing---that it should assume the more manly role of being a leader rather than create the impression of meekly following money market operations.

James Muir, 1960.

...........there is need for improved communication between the Bank of Canada and the chartered banks. Of course, communication must be a two-way street. I have long deplored the passing of bank rate in Canada from the realm of communication in this sense to a mere shadow, floating ¼% above the market rate for three month Treasury Bills. However, we must respect the Bank of Canada's evident determination to avoid even the possibility of a modest departure from the collective judgment of the free market.

Fortunately, the chartered banks are not yet reduced to the interpreting of obscure signs and portents or the reading of entrails to divine Bank of Canada policy; although a cynic might suggest that we have progressed very little beyond the plight of the noble savage watching as in olden times for the occasional smoke signal from the haughty Ottawas.

G. Arnold Hart- 1960.

The need for what might be termed a lead from the central monetary authorities is all the more apparent by reason of the curious method by which the central bank's rediscount rate is determined. In other money markets a change in the rediscount rate is rightly regarded as a matter of the highest significance. It traditionally represents a means by which central bank indicates to the market its views as to whether credit should become more stringent or more plentiful. In Canada, by contrast, the rediscount rate, since November 1956, has been determined weekly by the expedient of adding a quarter of one percent to the average weekly tender rate for three-month treasury bills. In other words, what in other money markets is a major monetary indicator that is changed infrequently and only in the light of official reappraisal of fundamental conditions, is in Canada like a cork that bobs around from week to week.......

J. Douglas Gibson- 1960

.......A clearer indication from the central bank to the business community as to the direction of its monetary thinking would therefore be helpful in promoting more stable financial conditions and perhaps in encouraging a level of long-term interest rates less restrictive to the potential borrower.

It is often said that we should return to the traditional system of having the central bank formally set the Bank Rate from time to time. The automatic system has been tried and, whatever its merits, it rules out the possibility of giving any signal or direction to the financial community. I think on balance it might be useful to restore the Bank Rate signal.......

Quest for Stability

.......Changes in the discount rate, as a symbol of Federal Reserve policy, may have important psychological effects. They reflect the recognition by a group of well-informed and responsible officials of a change in the credit situation. An increase in the rate indicates official concern over credit expansion and points toward a tighter credit policy. a decrease may be regarded as an indication of an easier credit policy and possibly lower interest rates.......

Exhibit 31. J. E. Coyne- 1956 Report

Finance companies carry on an operation which is in all essentials banking, but are not restrained by changes in monetary conditions. They are able to compete for deposits through the sale of short-term paper in the money market and to raise funds in securities markets, paying any necessary rate of interest for these purposes, for increased interest costs do not appear to deter consumer borrowing. Banks may not charge more than 6% interest on loans. Finance companies are not limited in this respect and their rates of interest or carrying charges range from 1% to 2% per month, i.e. 12% to 24% per year, or more. Some of the companies are subsidiaries of large foreign corporations and can obtain funds directly from them. Finance companies are not required to maintain reserves nor are they subject to regulation in the way that banks, life insurance companies and some other investment institutions are.

.......While consumer credit may be a useful adjunct of modern merchandising. large fluctuations in the volume of such credit make it a de-stabilizing factor working against the stabilizing efforts of fiscal and monetary policy. The existence of what amounts to a

rival banking system, competing for deposits and short-term funds in order to make short-term loans to finance consumption.......without supervision or regulation, and out of step with the trend of credit policy in the regular banking system, can be a definite handicap to monetary policy during a boom.......

James Muir- 1957.

The second source of additional inflationary pressure is the result of the growth of non-bank repositories of funds. Some of these are subject to governmental regulation or control, but not by our monetary authorities and not for purposes appropriate to monetary policy.

The curtailment of bank credit may have little direct effect on the supply of funds from non-bank sources. Even those institutions, such as the finance companies, with traditionally large bank loans, have alternative sources of funds, and these sources become more significant as the non-bank sector of the business community increases in importance as a repository of liquid funds.

It would seem, therefore, to be at least open to doubt whether the present facilities and techniques available to our monetary authorities are sufficiently wide in scope to deal with present-day problems of credit control. The classical weapon---upward movement of interest rates, largely through commercial banks---may by itself prove an impotent policy. The "bite" applied can sieze upon an insufficiently large segment of the whole money and credit system. Over the years, such an abundance of other forms of credit creation has arisen that the over-all supply of credit may move in a direction completely opposite to that which official monetary policy is trying to induce. It may be taking too positive a view of a distant scene, but it would at least appear that, in order to be fair and in order to achieve the best results, our monetary and credit control may have to embrace a wider area of our financial world than it now does.

James Muir- 1960

The implication of this ambiguity for policy is simply this, that monetary control is inhibited and may at times be ineffective, as well as inequitable, in controlling the money supply in this broader sense. Rather than extend the range of specific government regulation, it might be worth while to require that these lenders (who, in effect, do a banking business so far as the total supply of money and credit is concerned) should, like the chartered banks, be subject to appropriate cash, or other, reserve requirements.

Exhibit 32. G. F. Towers- 1936 Report

I believe that it was a wise move on the part of the leading Canadian Stock Exchanges to raise margin requirements during 1936, and I feel sure that they will have the co-operation of other lenders if--as may well be the case--further increases become necessary.

G. F. Towers- House of Commons, 1944.

I think it was in 1936--although I am speaking from memory--that it seemed to us that the very active and rising stock markets which were in existence at that time were tending to go to a shade too far in their use of increased credit, So that we did speak to the committees of the stock exchanges and also to the banks, and suggested that the percentage of margin requirements should be raised. That was a matter of suggestion and persuasion; but it did not take anything very much in that way, because I think that the

banks and the committees of the stock exchanges agreed that would be a wise move, and it was done.

Exhibit 33. G. F. Towers- 1946 Report

In the case of Canada where the chartered banks carry on both savings and commercial banking under one roof, an agreement was made with the government early in 1946 recognizing the link between savings deposits and holdings of market issues of government securities. The banks agreed that their investments in Dominion government direct and guaranteed issues (other than Treasury Bills, Deposit Certificates and Treasury Notes) would not average more than 90 per cent of the amount of their Canadian personal savings deposits. The banks also agreed that their earnings on such bonds should not exceed the cost of operating their savings business by more than a moderate profit margin.

Exhibit 34. G. F. Towers- 1948 Report

Before 1945, chartered banks seldom financed business capital expenditures through medium or long term loans. In the post-war period, however, the chartered banks extended a substantial amount of capital assistance to business through the purchase of corporate securities, particularly in 1947. Early in 1948 it became apparent that business intended to make even larger capital expenditures and that this might mean increased pressure on available labour and materials. Accordingly, the Bank in February 1948 suggested to the chartered banks that conditions prevailing at that time made it undesirable for capital expenditures to be financed through expansion of bank credit. We suggested that it would be preferable for borrowers to obtain such funds by the sale of securities to the public, except in the case of those borrowers, mainly small concerns, for whom a public issue would not be an appropriate means of financing.

Exhibit 35. G. F. Towers- 1951 Report

Meetings with representatives of the chartered banks during February 1951 to discuss the situation found the banks in agreement with the suggestion that further expansion in total bank credit was undesirable under existing conditions. To prevent such a development the banks undertook a more rigorous scutiny of applications for credit with a view to curtailing advances for less essential purposes and to encourage borrowers to go to the security market or elsewhere for their capital requirements.

Exhibit 36. J. E. Coyne- 1955 Report

Historically, in their role as commercial bankers, the chartered banks have not made a practice of term lending, that is, making loans to business corporations where the time of payment is deferred beyond that of ordinary bank loans, or purchasing a security issue negotiated directly with the customer as distinct from buying a publicly issued security in the market. In recent years, however, term lending has appeared in three distinct periods, with little such lending taking place in the intervals between. On each occasion the Bank of Canada has felt it necessary to propose and the banks have agreed to a cessation of most forms of term lending. The first occasion was from January 1948 to February 1949. The second occasion was from February 1951 to May 1952, this time in conjunction with a general ceiling on all forms of bank loans. The third such occasion came during 1955.

In September I discussed with the banks the rapid increase which appeared to be taking place in their term lending to corporations. In order that both the Bank of Canada and the chartered banks would be in a better position to appraise the situation, a weekly report from each bank of the amount of its forward commitments in respect of term lending... ....was instituted.......At the end of November it was agreed that all banks would in general cease making new commitments for term lending.

The agreement to refrain from term lending, as defined, does not prevent the banks from extending temporary credit to their customers for capital development programmes.......

Exhibit 37. J. E. Coyne- 1956 Report

Another step taken by the Bank with a view to reducing if possible outstanding anomalies was in connection with stock market credit required for margin trading. Increases in the amount of credit used for this purpose in the United States had prompted the Federal Reserve Board to exercise its powers to increase margin requirements from the previous level of 50%, to 60% in January 1955 and 70% in April 1955, a requirement which is still in force. As a result, the total volume of credit used for stock market trading did not significantly increase in the United States after April 1955. In Canada, on the other hand, the volume of credit so used had approximately doubled between March 1955 and July 1956. The general margin requirement according to the rules of the stock exchanges in Canada is 50%. The Bank of Canada has no power to impose or alter margin requirements. The Bank did, however, have a discussion with members of the governing bodies of the Montreal, Canadian and Toronto Stock Exchanges, in the course of which general agreement was expressed that it would be undesirable for the volume of credit used in stock trading to increase any further under present conditions.......

Exhibit 38. J. E. Coyne- 1956 Report

Again, it became apparent during 1956 that the volume of consumer credit, particularly in the form of instalment finance, was expanding more rapidly than other forms of credit, such as ordinary bank loans, and was continuing to expand rapidly in the latter part of the year after bank credit had more or less levelled off. The Bank held discussions with representatives of the major instalment finance companies with a view to seeing whether some voluntary agreement could be reached among the leaders of the industry to prevent any further significant increase in the total volume of credit of this character. It turned out that agreement of all concerned could not be reached.......The Bank also had an informal discussion with representatives of the major department stores and chain stores engaged in selling consumers' durable goods on credit, many of which do their own financing but also depend on occasion upon funds provided by the instalment finance companies. These representatives expressed the view that in their business credit terms had not been relaxed, and no agreement was reached with respect to restraining further increase in the volume of consumer credit extended through these outlets.......

Exhibit 39. J. E. Coyne- 1957 Report

In the early months of 1957 the chartered banks had virtually withdrawn from the field of insured residential mortgage lending,.......

In discussing this situation with the chartered banks I expressed the view that they should maintain continuity in mortgage lending as an important field of investment for

savings entrusted to them. At a meeting in March the banks agreed to resume operations in this field on much the same scale as in 1956.......Bank of Canada indicated that the total resources of the banks as a group could be expected to increase during 1957 by an amount at least great enough to take care of their disbursements on mortgage loans in that year, so that it would not be necessary for the banks to dispose of other assets in order to maintain a flow of funds for insured housing loans.

Exhibit 40. J. E. Coyne- 1956 Report

Long term investments made from and limited by funds accruing from the growth of savings deposits are in quite a different category from credit expansion in the form of current or demand loans to businesses and individuals, which may reach excessive proportions ....the financing of such credit expansion through the use of funds arising from savings deposits, both directly and from the sale of Government bonds in which savings deposits previously received had been invested, has been one of the less predictable and less stable features of monetary developments over the past two years.......In Canada this has been more noticeable perhaps than elsewhere because of the extent to which commercial banking functions and savings banking functions are intermingled in the operations of the chartered banks. Over 80% of total personal savings deposits in Canada are held with the chartered banks, and the pattern of investment of such deposits has varied widely at different times. The banks may under conditions of inflationary pressure expand their commercial and general loans and other forms of short-term credit from such funds, which in other times would go into long-term investments.......the availability for commercial and general loans of funds that can be obtained by the banks by selling in large volume the Government securities in which a considerable proportion of their savings deposits had previously been invested. By this means, the greater part of the resources of the banks' savings departments have been available as required from time to time to augment the other resources of the banks' commercial banking departments when the demand for commercial loans has been particularly great.......

Exhibit 41. J. E. Coyne- 1959 Report

By April the banks were becoming concerned about the rate of growth in their loans. On May 14 following a series of meetings the President of the Canadian Bankers' Association issued a public statement saying that the banks intended to exercise the utmost care in the handling of their credit facilities, in order to avoid any significant further increase in the over-all total of bank loans, and that within these limitations, a special attempt would be made to look after the essential credit needs of small borrowers.

At the annual meeting of the Canadian Bankers' Association on June 12, 1959, the President in his published address re-affirmed the statement of May 14.

Nevertheless, the banks experienced great difficulty in bringing their loans under control.......

Exhibit 42. Hon. D. M. Fleming- House of Commons, 1962.

.......There has been no change in policy. After Mr. Rasminsky had taken over his duties last summer as governor of the bank he met with representatives of a number of leading investment houses in Canada and proposed to them that for the time being it would be desirable that they should not undertake financing in the United States market, with

the opportunities that existed in Canada for that purpose. It was expected that this would be for a temporary period and, in the view of the governor, that period has now been concluded. All he did was to inform the financial houses that he would no longer ask them, as I am informed, to refrain from doing financing in the United States market if they thought it proper to do so, but he has not suggested to them that they should do so.

Exhibit 43. Macmillan Report

235. We are now in a position to sum up our general views on the question of a central banking institution for Canada. We should perhaps sound a note of warning as to the degree to which such an institution could fulfil all the expectations that the public mind might attach to it. A central bank could not cure all the economic ills of Canada; it would not be a source of unlimited credit for all borrowers on all occasions; indeed its operations might as often be restrictive as expansive.

G. F. Towers- House of Commons, 1939.

No amount of monetary expansion can hope to restore a high level of real national income in Canada during a period when there is a major decline.......in the demand for our goods in foreign markets.......it cannot create an important demand for goods which we would normally export nor can it.......create new industries to absorb man-power....... from depressed export industries.......

G. F. Towers- House of Commons, 1954.

.......I certainly would not suggest that monetary policy, or indeed the best of fiscal policies, are all that is needed to ensure a prosperous country. I think they can help. But I do not think the two things can in any way be completely divorced. In other words, I think that they are a team which has to be driven in double harness. A monetary policy which is striving to counteract inflation will be defeated by a fiscal policy which is highly inflationary.......While there could be variation in one or the other, depending upon the general situation, they must be generally non-contradictory.......if you have a country in which the fiscal policy is extremely inflationary, then the central bank cannot prevent the resultant extremes.......

J. E. Coyne- 1956 Report

It is doubtful if monetary policy can be expected by any reasonable degree of severity in its application to prevent price inflation entirely in the face of pressures of the nature and degree experienced last year in Canada and in many other countries.......Since it is the duty of the central bank to resist excessive tendencies towards either inflation or deflation in the economy, it has sometimes been described as being required to "lean against the wind". Perhaps a more accurate description would be to say that in seeking to act as a stabilizing factor in relation to the total rate of spending in the economy, the job of the central bank is to yield somewhat to the wind but offer increasing resistance.......While the central bank can influence the quantity of money (currency and bank deposits), there is no fixed relationship between the quantity of money and the rate of spending. At any given moment a varying proportion of the money supply is inactive, lying in dormant deposits, but capable of being activated if sufficient incentive is offered. Rising interest rates and increased efforts by would-be borrowers cause the owners of previously inactive deposits to lend them to those who want to make capital expenditures, or other expenditures.......The maintenance of orderly conditions in financial markets, and the avoidance of a serious disruption of the flow of funds from savings

to investment, is a responsibility of a central bank, both in the interests of economic growth and in the interests of government finance and the government securities market through which (by buying or selling securities) the central bank is able to regulate the money supply.

J. E. Coyne- 1957 Report

There are limits to the role of monetary policy in any free economy, and this applies with particular force to a country so dependent upon foreign trade as Canada. We must view the changing economic conditions in our economy in the context of the vicissitudes of our great trading partners.......Many of the investment decisions with regard to resource development in Canada are made by non-resident investors. Much depends on the degree of business optimism outside our borders as well as within Canada.......But this does not absolve us from the necessity of having a monetary policy of our own, in order to minimize the adverse effects of developments abroad and to inhibit the growth of unfavourable fluctuations of domestic origin.

Louis Rasminsky- July 31, 1961, Statement

Too much reliance on monetary policy either as a restraining or a stimulating factor would, however, lead to unsatisfactory self-defeating results. If one were to try to control the excesses of a boom period through monetary policy without adequate support from appropriate fiscal, debt management and other economic policies of Government, one would run the risk of creating great strains in the financial system in the form of intolerably high interest rates and disorganization in capital markets. On the other hand, the precise part that monetary policy can appropriately play in stimulating economic expansion is necessarily influenced by the part being played by the concurrent fiscal, debt management and other economic policies of Government. The central bank has an important part to play in influencing the trend of interest rates in a direction appropriate to the economic situation. But an attempt on its part to impose a level of interest rates which appeared unrealistic to the market would impair confidence in the value of the currency and present a serious obstacle to the orderly flow of funds through the capital market.

Louis Rasminsky- 1961 Report

Good economic performance depends both on financial policies and on the basic elements of economic efficiency--a well-trained, energetic and adaptable working population, dynamic business leadership, the imaginative application of modern technology, good marketing practices, and perhaps above all the determination to be competitive. These basic factors need an environment of appropriate financial policies if they are to make their maximum contribution to the achievement of our economic goals. But if the basic factors themselves are missing, their absence cannot be adequately compensated by variations in the cost and availability of credit, or by variations in the foreign exchange rate, or indeed by any kind of purely financial management.

Quest for Stability

.......The Federal Reserve is limited in what it can accomplish through influencing the money flow. In the first place, the System can influence only one of the two determinants of the flow of money expenditures---the quantity of money but not its velocity of circulation. Second, the instruments available to the System are more effective in checking a boom than in promoting recovery from a depression. Inflation can be checked by limiting the money supply, but expansion can only be encouraged during depression by making more reserves available. It is more effective "to pull on a string than to push"; nevertheless, by providing banks with an ample supply of reserves and putting a plentiful

supply of funds in the market, the System can at least cushion a decline........If labor and other organized groups exert enough pressure to force money incomes up faster than the increase in productivity, monetary and fiscal authorities may be confronted with choosing between two alternatives---an expansion in the money supply to support higher costs and rising prices, or unemployment. Thus monetary and fiscal policies, no matter how well conceived and expertly executed, may not be able to maintain stability in the face of inappropriate wage and other income policies.

W. McC. Martin- 1961 Speech

The Federal Reserve intends now, as in the past, to make vigorous use of its monetary powers in order to contribute to the attainment of conditions conducive to a productive, actively employed, steadily growing economy with relatively stable prices.

But clearly those conditions cannot be provided by monetary policy alone. Help is needed, especially in directly attacking some of the problems of unemployment that cannot reasonably be solved by credit measures. Without such help, we might find at some point that the plague of unemployment was still with us, but by then it had been compounded by inflation.

What is needed, in my judgment, is a judicious blend of specific actions, well-balanced monetary and fiscal policies, and wage-price policies fitting to a vigorously competitive market structure.......

Neither can we afford to be priced out of the market by currency inflation: in our governmental processes we must guard against reckless budgetary and monetary practices that can undermine the value of our currency, and with it undermine our competitive position as both sellers and buyers of goods and services throughout the world.

Lord Cobbold- 1961

"I also accept--indeed it is a theme which I have myself argued for many years past--that monetary policy cannot cure all ills and that it is a great mistake to expect it to carry loads which should be carried in other fields of government policy."

As quoted by Honourable Donald M. Fleming in the House of Commons, February 21, 1961.

<u>Exhibit 44.</u> J. E. Coyne- 1960 Speech

.......In a serious depression, unemployment is of such a magnitude and of such a widespread character that general measures of monetary expansion and deficit financing may be expected to make a major contribution towards encouraging an increase in production and employment throughout the country. Of course, no great assistance will be derived by industries dependent upon export markets from an increase in spending and spending power merely within Canada itself. If, however, industries producing for the domestic market are also suffering from serious and general under-employment---and if this is not due to high costs and inability to compete with imports but is a reflection of a low level of spending within the country---it is apparent that general measures to increase the ability of people and businesses to spend, and to undertake new projects with the aid of borrowed money, may have a quite pronounced beneficial effect. Such measures can in such circumstances improve the rate of activity in industries producing for the domestic market, including of course a wide variety of service industries as well as goods-producing industries.

On the other hand, what has not been so widely recognized is that if unemployment is not general but is chiefly apparent in the export industries, or is scattered in particular industries or particular localities for reasons peculiar to those industries or localities, a general increase in money and credit, with or without a general degree of deficit spending by the government, will not necessarily have any useful effect on the particular areas of unemployment in question. Moreover, if at such a time industries producing for the domestic market are for the most part operating at a high level--or even if they are under-employed where the cause is inability to compete with imports--one would expect that a general expansion of the money supply and of credit available through the banking system, or large scale government deficits, would tend to result in increased imports--that is to say in a stimulus to production and employment outside Canada--rather than increased production and employment inside Canada.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX D

MUNICIPAL FINANCE

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX D

MUNICIPAL FINANCE

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MUNICIPAL FINANCE

INTRODUCTION

1. The division of responsibility among the different levels of government in Canada is most complex. Responsibility for matters primarily affecting only local residents forms the basis for the existence, and the delineation of authority, of the Canadian municipality. Such matters include protection to persons and property, local public works, sanitation, health and welfare, and recreation. While education is considered to be a provincial responsibility, the provision of educational facilities and teachers is treated as a local responsibility, to be supported in part, or entirely, by local resources. In order to carry out these responsibilities the municipality possesses the power to borrow capital funds for the provision of the necessary capital works.

2. However, the Canadian municipality owes its existence and its authority to the province in which it is situated. Consequently, the provinces can and do exercise considerable control over their municipalities and accept substantial responsibility for their welfare. The provinces differ somewhat in their views as to the extent to which provincial authority and responsibility should be exercised, with the result that varying degrees of municipal autonomy and provincial assistance exist across Canada.

3. The municipality's special sphere of operations has created unique financing operations and market characteristics for municipal obligations which make it desirable to consider municipal capital financing separately from provincial finance. Comment on its various aspects has been divided as follows:

- I Sources of Capital
- II Sale of new Debenture Issues by the Municipality
- III The Evaluation of Municipal Debentures
- IV The Market for Municipal Debentures
- V Marketing Assistance from Senior Governments

I SOURCES OF CAPITAL

4. A municipality has three basic sources of capital, namely: current revenues, grants from senior governments and proceeds from the sale of its debentures. The federal and provincial governments do make capital grants for construction costs of certain works including hospitals, homes for the aged, some roads and bridges, schools, and water and sewer works, but the largest source of capital is the proceeds from the sale of new debentures.

5. The rapid population growth since 1945, as well as the trend to higher standards of municipal services, has resulted in constantly increasing municipal capital requirements. A number of provinces have adopted measures to assist municipalities in borrowing for these capital funds, including the establishment of provincial corporations to buy municipal debentures with funds raised by the sale of the corporations' own provincially guaranteed bonds. Such corporations include the Alberta Municipal Financing Corporation (a) and the Ontario Municipal Improvement Corporation (b). The former provides all capital funds required by Alberta municipalities at rates in accordance with the cost of money borrowed by the Corporation, plus operating costs. The latter is designed to provide capital only to those municipalities which are not in a position to borrow in the market at reasonable rates.

6. In some provinces, part of the capital raised by debenture sales is, in effect, provided by the province by means of annual grants of a percentage of annual service charges on debentures. This procedure helps preserve autonomy and self-reliance, as the municipality or school board still has an interest in striving for low borrowing costs. Such grants do result in lower borrowing costs. This occurs because the percentage of debenture debt supported by grants may be excluded from debt to be paid from taxes. In general, the lower the tax supported debt, the better the credit rating, resulting in lower borrowing costs.

(a) The Alberta Municipal Financing Corporation Act. Chapter 3, Statutes of Alberta, 1956

(b) Ontario Municipal Improvement Corporation Act. Chapter 263, Revised Statutes of Ontario, 1950

II SALE OF NEW DEBENTURE ISSUES BY THE MUNICIPALITY

7. The traditional method of selling new debenture issues has been to call for tenders from investment dealers. It is reasonable to assume that, under normal market conditions, an established municipality with a moderate capital borrowing programme can achieve the best results by this method.

8. However, there are many Canadian municipalities which are not always in such a fortunate position. A municipality with a heavy borrowing programme in prospect for several years may be well advised to market its large issues through a fiscal agency group, thus assuring broad distribution facilities to assist in the successful sale of each issue. Municipalities which have adopted the fiscal agency method include the cities of Ottawa, Hamilton and Vancouver and the Municipality of Metropolitan Toronto.

9. A municipality in a special situation, one which needs its story well told, will also benefit from the services of fiscal agents. Such a municipality might have had past difficulties only recently overcome, be newly created, or have changed in character due to annexation or rapid urban development. Municipalities which have sold debentures through fiscal agents for one of these reasons include District of Kitimat B.C., City of Windsor Ontario, the County of Halifax N.S. and the Township of Toronto, Ontario.

10. In general, the smaller but well administered municipality can afford to try for the highest possible price on each issue as it comes along, with the knowledge that a poor marketing operation on any one issue is unlikely to affect its general credit rating or its future issues.

11. The manner of calling for tenders is worthy of attention. In many instances tender notices are despatched to selected lists of dealers. However, in most cases where notices have appeared publicly, the responses have been

more numerous and consequently more indicative of market levels. It is suggested that notices be published in the Official Gazette of the province concerned so that all dealers would have the opportunity to submit tenders. Issues should be awarded to the tenderer whose bid provides capital at the lowest cost, provided that the borrower and provincial authorities are satisfied with the financial stability of the bidder and that the tender is in accordance with the terms and conditions contained in the call for tenders.

III THE EVALUATION OF MUNICIPAL DEBENTURES

12. The value of a municipal debenture is determined by comparing the features of the issuer with those of other municipal borrowers in order to establish a relative worth. Obviously certain basic information must be obtained before accurate evaluation can be made, and many dealers in municipal debentures have declined to bid for new issues, at one time or another, simply because sufficient information was not made available.

13. The items usually considered to be most important are the amount, quality and diversity of assessment, the tax collection record, the weight of debt and the debt history. A more detailed list of relevant items is contained in Exhibit "A", appended. While the information referred to in this Exhibit is more detailed that is necessary in many instance, a good general rule is that the more information available, the more satisfactory the sale of debentures is likely to be.

14. It is usually difficult to compare the financial positions of municipalities in different provinces because bases of assessment and municipal accounting procedures vary from province to province, and sometimes from municipality to municipality in the same province. Most provinces publish some form of annual municipal statistics which appear to be standardized for their own municipalities at least. Many of these publications are far from satisfactory, however, as they contain insufficient facts and little information. Steps should be taken to rectify this lack of data.

15. Once the basic value of a municipal debenture is established and an approximate market rate arrived at by comparison with other issues, this rate is adjusted for the features of the issue itself. These features include the term to maturity, redemption clause and coupon interest rates.

IV THE MARKET FOR MUNICIPAL DEBENTURES

16. Canadian and American investing institutions are the largest buyers of Canadian municipal debentures and slightly over sixty percent of those outstanding are held by this category. The most important Canadian institutional purchasers of the shorter maturities are chartered banks, trust companies and Quebec financial co-operatives (caisses) and of the longer maturities, insurance companies and pension funds. American investments in Canadian municipal debentures are held almost entirely by insurance companies and pension funds.

17. The estimated distribution of municipal debenture holdings is given in Exhibit "B", appended. It will be noted that some 35 percent of the ddbentures held in Canada are owned by investors other than institutional and government accounts.

18. The annual capital requirements of Canadian municipalities are substantial, the estimated $471 million requirements in 1961, representing some 46.5% of total provincial financing. Exhibit "C" shows the dollar volume of new provincial and municipal issues sold in recent years. The dollar volume sold to Canadian institutional buyers has depended to some extent on the yield spread from provincial bonds. While insurance companies do allocate specific amounts of investment funds for the purchase of particular classes of securities, it has been proven many times that such allocations may be adjusted readily when one class appears more or less attractive in yield than others. It will be seen from the exhibit that substantial amounts of capital have been raised in the past through the sale of both provincial and municipal issues outside of Canada. This form of borrowing has been necessitated by the fact that demands on the internal market have been so heavy that it would have

been difficult for it to completely absorb the volume of new issues. There has been the added advantage that in most cases external borrowings have been effected at more advantageous rates than were available in Canada at the time. However, the imposition of a 15% Federal Withholding Tax could increase the cost to Canadian borrowers to such an extent as to make external borrowing uneconomical, as foreign investors require an increase in yield in order to compensate them for the loss involved due to the tax. With the large volume of financing facing our municipalities in the forseeable future, we recommend that the tax be rescinded so that this source of funds will again be available to them.

19. The marketing of municipal debentures is more specialized than provincial and many corporate securities. One of the reasons for this is the preponderance of serial forms of issues. Some municipalities have adopted the installment type instead of the true serial. In its original form, a twenty year installment issue, which is based on equal annual installments of principal and interest, comprises twenty different maturities with a varying amount of debentures in each maturity and at least one debenture in each maturity with a par value of an odd number of dollars and cents. The maturities comprising an actual debenture issue which was marketed in 1960 are shown in Exhibit "D". It is difficult to sell serial issues to the general public because of the problems in merchandising so many different maturities, frequently at different dollar prices. Many investors dislike the book-keeping and handling problems involved in a multi-maturity investment.

20. Institutional investors and private individuals form the two groups that purchase municipal and school debentures. The former may be divided into two categories, the chartered banks, trust companies and Quebec financial co-operatives forming one and insurance companies, pension funds and various government accounts the other. The first category usually prefers short term serials maturing not later than ten years, although there are times when they may stop at earlier maturities. On the other hand while insurance companies and pension funds may prefer long term non-callable sinking fund

debentures, they do buy long term serials. The requirements of individuals vary from person to person. This leads us to believe that issues containing serial maturities in the early years as well as a long term sinking fund maturity or maturities should satisfy the requirements of the various types of investors. In following this method, it should be possible to vary the maturity dates of the serial and sinking fund debentures in accordance with changing market conditions.

21. It is usually difficult to maintain active secondary markets for debentures of smaller borrowers. The operations of sinking funds would certainly create some demand for the outstanding debentures of these borrowers.

It will be helpful if sinking funds which are established against specific issues are not restricted to the purchases of debentures of those same issues but would be open to any debentures of the borrower. With the exception of larger municipalities, sinking funds should be supervised by the appropriate provincial authorities in order to provide knowledgeable assistance.

22. There are two federal requirements at present which tend to restrict the market for municipal and school board debentures to some extent. For the purpose of annual portfolio evaluation by Canadian life insurance companies, the Department of Insurance allows the evaluation of federal and provincial obligations, both direct and guaranteed, to be the companies' amortized book values. However, this method is not accepted for municipal securities. This tends to make such obligations relatively more attractive than municipal obligations to life insurance companies than would otherwise be the case. Consideration should be given to allowing insurance companies to evaluate municipal debentures in a like manner.

23. The Department of Insurance in Ottawa requires non-resident insurance companies to deposit, with it, acceptable bonds and debentures as security for these companies' Canadian policy holders. Municipal debentures are acceptable for this purpose but school debentures are not eligible for deposit unless they bear a provincial or municipal guarantee. The acceptance of school debentures for deposit would benefit the market for these securities.

24. There is a strong feeling among many municipal officials that the issuance of tax-exempt debentures in Canada, similar to those issued by United States borrowers, would result in substantially lower debt service charges to Canadian issuers. At first glance this appears to be the case, but further study proves it to be doubtful. For instance pension funds, large buyers of municipal securities, would derive no benefit whatever from the exemption so that they would be lost to the market. Taxation of chartered banks and insurance companies is not based solely on investment income, so that the exemption might have little appeal to them and their purchases could decrease. This would result in upper bracket taxable accounts being the principle source of capital available to municipalities and the volume that might be generated from this source might not be substantial. It is possible that a few tax-exempt issues might be successfully sold, but it would not take long for the yields on tax-exempts to increase so as to almost coincide with those on taxable securities. For these reasons we recommend that tax-exempt status not be given to municipal debentures. Recent experience in the United States tends to support this conclusion as is indicated by the appended quotation from an article "Should the Income Tax Be Overhauled?" in the December 1961 Monthly Review, issued by The Federal Reserve Bank of Kansas City (Exhibit "E").

V MARKETING ASSISTANCE BY PROVINCIAL GOVERNMENTS

25. The various provinces assist their municipalities in one way or another to sell debentures. The simplest form of assistance, one which has proven very effective, is to require municipalities to provide information about their history, economic and financial condition, and details of the proposed issues. The information is included in standard information forms which are made available to prospective bidders. In some instances the provinces issue calls for tenders incorporating this information.

26. Another effective device is being used by some of the provinces in assisting in the marketing of school debentures. These provinces remit agreed upon grants to the paying agents for the debentures with the proviso that the funds are to be used in the servicing of the debt in the years in

in which the grants are received. This improvement in the security of school debentures has resulted in borrowing costs being substantially lower than otherwise would have been the case. However, we recommend when grants are not statutory that they be made so rather than continuing the present practice of requisitioning the amounts annually. In addition to this their description in the texts of the debentures secured by them should assist in a wider acceptance of this type of investment.

27. In some provinces assistance has been offered to the underwriter, rather than directly to the municipality, by purchases by provincial accounts of some part of each issue. In some cases the purchasing intentions of these accounts are made known to dealers prior to the sale of the debentures. In other instances the province has made known its policy of assistance by government account purchases in the event that the issue is not successfully marketed within a reasonable time. This policy has had the double effect of increasing dealer confidence in underwriting municipal issues and of avoiding the adverse effects that unsold issues have on the new issues of adjacent and similar municipalities.

28. Probably the most effective form of provincial marketing assistance has been the provincial guarantee of principal and interest payments. All provinces have resorted to this device at one time or another and it is undoubtedly of major assistance in marketing issues of little known or low rated municipalities and school-boards.

MUNICIPAL FINANCE, RECOMMENDATIONS FOR THE I.D.A.C. BRIEF

Pr. 22 page 7	a)	We recommend that life insurance companies be permitted to evaluate their holdings of municipal securities at the amortized book values following the same practice as for federal and provincial obligations.
Pr. 23 page 7	b)	We recommend that the Federal Department of Insurance accept school debentures for deposit by non-resident insurance companies.
Pr. 24 page 8 Exhibit "E"	c)	We recommend that the tax status of interest payments on municipal debentures remain unchanged.

EXHIBIT "A"

Evaluation of Municipal Debentures

Factors Affecting a Municipality's Credit Rating

General

1. Geographical location

2. Physical appearance, size (acreage)

3. Economy
   - a) type - agricultural, industrial, etc.
   - b) extent and wealth of marketing area
   - c) quality of housing

4. Condition and extent of municipal facilities
   - a) water service
   - b) sewer service and treatment
   - c) roads, sidewalks, bridges

5. Extent of control over development
   - a) zoning by law
   - b) in rural or semi-rural, method of controlling urban growth

6. Management
   - ability of council and political climate
   - ability of appointed officers

Statistical Statistics for at least the past five years are examined so that trends may be detected.

7. Population
   - a) total
   - b) rate payers

8. Assessment
   - a) residential, commercial and industrial categories
   - b) per capita
   - c) relationship to current market values
   - d) exemptions

...

9. Current Operations

- a) accuracy of budgeting as evidenced by annual surpluses or deficits and outstanding temporary loans
- b) ability of tax payers to pay and the municipality to collect taxes as shown by current and total tax collections as a percentage of current levy and total outstanding tax arrears as a percentage of current levy and per capita. Explanation of arrears, if unduly high, such as date tax bills are sent out.
- c) reserves against tax arrears and breakdown of arrears into years in which they occurred.

10. Debt

- a) breakdown: self-supporting
  local improvements
  general service debt
- b) ability to pay off debenture debt as indicated by the relationship of debt repayable from taxation to population and assessment and by the percentage that annual debt charges are of annual current revenues
- c) willingness to pay as indicated by debt history
- d) forecast of future borrowing.

Exhibit "B"

ESTIMATED DISTRIBUTION OF HOLDINGS
OF
MUNICIPAL DIRECT & GUARANTEED DEBENTURES

As at December 31, in $ millions

	1956	1957	1958	1959	1960(1)
Life Insurance Companies (2)	399	427	456	507	547
Provincial Governments (3)	156	192	237	257	286
Pension Plans	158	170	183	205	235
Chartered Banks	185	168	195	204	208
Municipal Governments (4)	117	137	158	191	207
Other Insurance Companies (5)	85	97	103	110	121
Trust & Mortgage Loan Companies (6)	48	47	55	55	71
Quebec Savings Banks	56	52	53	47	41
All other residents (residual)	673	764	819	883	955
TOTAL RESIDENT HOLDINGS	1,877	2,054	2,259	2,459	2,671
Non-Resident Holdings	550	656	780	912	1,024
TOTAL	2,427	2,710	3,039	3,371	3,695

Notes:

(1) Estimated
(2) Registered under Federal Insurance Acts
(3) Includes holdings of various Funds under provincial jurisdiction such as hydro commission, workmen's compensation boards, sinking Funds, teachers and civil service pension and superannuation Funds
(4) Based on a sample of those large cities which provide details of their investments in their published annual reports. Includes holdings of various Funds under municipal jurisdiction, such as sinking Funds and pension Funds
(5) Fire and casualty insurance companies and fraternal benefit societies registered under Federal Insurance Acts
(6) Holdings of all such companies registered with the Government of Canada or the Province of Ontario or Quebec, plus holdings of Investors Syndicate of Canada Limited (incorporated in Manitoba)

SOURCE: Bank of Canada Statistical Summary, January 1962

EXHIBIT "C"

GROSS NEW ISSUES, RETIREMENTS AND NET NEW ISSUES

OF

MUNICIPAL DIRECT AND GUARANTEED BONDS (1)

Callendar Year	Gross New Issues Delivered			Retirements (2)			Net New Issues		
	Cdn $ Only	Other Currencies	Total	Cdn $ Only	Other Currencies	Total	Cdn $ Only	Other Currencies	Total
1954	305	38	343	83	20	103	222	18	240
1955	302	42	344	86	25	111	217	17	234
1956	247	108	355	107	24	131	140	84	224
1957	292	123	414	110	26	136	181	97	278
1958	347	148	495	139	33	172	208	115	323
1959	370	146	516	157	33	191	213	113	326
1960	411	122	533	177	38	214	234	85	319
1961	445	29	474	180	41	221	265	(12)	252

Notes:

(1) Excluding Municipal issues guaranteed by provinces, and issues sold directly to provinces

(2) Excluding Payments into sinking funds

Source: Bank of Canada Statistical Summary, February 1962.

Exhibit "D"

$1,063,732.52
CITY OF CORNWALL
6% and 6½% Instalment Debentures

Schedule of Maturities

Year	$12,000.00 Garage #1,017 Dated: Oct. 1/60 6%	$75,000.00 Land and Buildings #1,041 Dated: Oct. 1/60 6%	$86,125.53 Waterworks #1,016 Dated: Oct. 1/60 6%	$306,412.60 Local Improvements #1,037 Dated: Oct. 1/60 6%	$102,797.22 Public Sch. Board #1,014 Dated: Sept. 1/60 6%	$126,059.56 Waterworks #1,015 Dated: Oct. 1/60 6%	$150,000.00 Cornwall Gen. Hospital #1,042 Dated: Oct. 1/60 6%	$161,259.35 Filtration Plant # 949 Dated: June 1/60 6%	$2,510.60 Local Improvements # 943 Dated: June 1/60 6½%	$3,744.47 Local Improvements # 942 Dated: June 1/60 6½%	$37,823.19 Local Improvements # 941 Dated: June 1/60 6½%
1961	$2,128.76	$ 5,690.10	$ 6,534.17	$ 23,246.91	$ 2,794.50	$ 3,426.88	$ 4,077.68	$ 4,383.77	$ 186.05	$ 277.48	$ 2,802.88
1962	2,256.48	6,031.50	6,926.22	24,641.71	2,962.17	3,632.49	4,322.34	4,646.79	198.14	295.52	2,985.06
1963	2,391.87	6,393.39	7,341.79	26,120.22	3,139.90	3,850.44	4,581.69	4,925.60	211.02	314.73	3,179.09
1964	2,535.38	6,777.00	7,782.30	27,687.43	3,328.29	4,081.47	4,856.59	5,221.14	224.74	335.19	3,385.73
1965	2,687.51	7,183.62	8,249.24	29,348.68	3,527.99	4,326.35	5,147.99	5,534.40	239.34	356.97	3,605.81
1966		7,614.63	8,744.19	31,109.60	3,739.67	4,585.93	5,456.87	5,866.47	254.90	380.18	3,840.18
1967		8,071.51	9,268.84	32,976.16	3,964.05	4,861.09	5,784.28	6,218.46	271.47	404.89	4,089.80
1968		8,555.80	9,824.97	34,954.73	4,201.89	5,152.76	6,131.33	6,591.56	289.12	431.20	4,355.63
1969		9,069.15	10,414.47	37,052.02	4,454.00	5,461.92	6,499.21	6,987.06	307.90	459.23	4,638.75
1970		9,613.30	11,039.34	39,275.14	4,721.24	5,789.64	6,889.16	7,406.28	327.92	489.08	4,940.26
1971					5,004.52	6,137.02	7,302.51	7,850.65			
1972					5,304.79	6,505.24	7,740.66	8,321.69			
1973					5,623.08	6,895.55	8,205.10	8,820.99			
1974					5,960.46	7,309.28	8,697.41	9,350.25			
1975					6,318.09	7,747.84	9,219.25	9,911.27			
1976					6,697.18	8,212.71	9,772.41	10,505.94			
1977					7,099.01	8,705.47	10,358.75	11,136.30			
1978					7,524.94	9,227.80	10,980.27	11,804.48			
1979					7,976.43	9,781.47	11,639.08	12,512.74			
1980					8,455.02	10,368.21	12,337.42	13,263.51			
	$12,000.00	$75,000.00	$86,125.53	$ 306,412.60	$102,797.22	$126,059.56	$150,000.00	$ 161,259.35	$2,510.60	$3,744.47	$37,823.19

FEDERAL RESERVE BANK OF KANSAS CITY

Exhibit "E"

MONTHLY REVIEW

December 1961

Should the Income Tax be Overhauled?

Taxing State and Local Interest

A clear-cut example of the economic effects of favoured tax status is found in the market for state and local securities. Because interest paid on these securities is exempt from the Federal income tax, investors are willing to buy state and local bonds as lower yields than those available on other securities.... ..... The preference of investors for tax-exempt bonds has made it possible for state and local governments to borrow at rates substantially below rates paid by other borrowers. However, as state and local government borrowing has mushroomedover the postwar period, the demand of high bracket taxpayers for tax-exempt securities has tended to become satiated. It has thus become increasingly necessary for nontaxable bonds to carry yields that make them appealing to investors in lower tax brackets. In consequence, the rate advantage for state and local issues has diminished considerably in recent years, while the advantage of investing in tax-exempt issues has been enhanced for people in higher tax brackets.

In 1946, tax-exempt issues rated Aaa sold at yields less than one half as high as those on corporate securities of comparable quality. The subsequent heavy volume of municipal offerings has progressively reduced this differential. Last year, for example, Aaa-rated state and local issues sold at rates nearly three fourths as high as those on comparable corporate issues. It was thus possible for investors in the highest brackets to find substantial shelter from tax progression. A taxpayer in the highest (91 per cent) bracket could realize a tax-free return of $32,600 per year on a $1 million investment in Aaa-rated state and local bonds at the average rate available in 1960. He could earn, after tax, only about $4,000 annually from an equal investment in Aaa-rated corporate issues at the average rate for 1960.

Not only does this state of affairs provide an unwarranted haven from tax progression, it is often argued, but it also encourages investment in rather safe securities by those who are in the best position to finance riskier private undertakings, the income from which is taxable.

...

Tax exemption of state and local interest payments has often been defended on the ground that it subsidizes desirable spending programs by reducing the borrowing costs of lower levels of government. However, the postwar decline of the differential between tax-exempt bonds and taxable issues has called into serious question the efficiency of the tax exemption feature as a subsidy for state and local borrowing. Taxpayers in high brackets save in taxes (and the Federal Government thereby loses in revenue) an amount far in excess of the saving of interest costs to lower levels of government.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX E

Part I - Corporation Finance

Part II - Legislation

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

CORPORATION FINANCE

1. A discussion of corporation finance should logically begin with an examination of companies themselves - how they have grown, how much money has been used in the expansion of corporate enterprise and how this expansion has been financed. It is unfortunate that no one set of figures exists that permits a definitive analysis of changes in the structure of Canadian corporate finance. There are, however, statistics published by various authorities from which conclusions can be drawn that in general are probably fairly accurate.

2. The most comprehensive of these are the taxation data published by the Department of National Revenue, the latest of which relate to the year 1959. During the ten years 1949-59 the number of fully tabulated companies in Canada rose from 35,706 to 86,996; their assets, net of depreciation and depletion writeoffs, grew threefold from $21 billion to $63 billion. The following is a summary of the source and application of funds of Canadian business over this ten year period, as derived from the Taxation Statistics.

TABLE I.
Source and Application of Funds of Canadian Business 1949-59.

	($ billions)
Application	
Increase in net working capital	10.0
Increase in gross fixed assets	23.4
Net investment in subsidiaries and affiliates	7.5
Increase in other assets	2.2
Total applications	43.1
Sources	
Depreciation, depletion, etc.	8.7
Retained earnings and other surplus	11.3
Total internal sources	20.0
Other liabilities	6.8
Debt	7.8
Equity (preferred and common stock)	8.5
	43.1

"Other liabilities" include loans due to affiliated companies, liability reserves (including deferred taxes) and deferred income.

3. Four important reservations apply to these figures:

1) The increase in fixed assets and in depreciation is after sales of fixed assets, for which figures are not published. Other data published in the taxation statistics show total capital expenditures by tabulated companies from 1950-59 as $26.4 billions. Capital cost allowances claimed for tax purposes amounted to $14.8 billions, or 56.2% of this amount, while retained earnings were a further $7.6 billions, or 28.3%. Cash dividends paid added up to $10.5 billions out of net profits of $18 billions, an average pay-out of 60%.

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2) The increase in surplus includes capital surplus, part of which would consist of proceeds from sale of stock in excess of par value.

3) The increase in common and preferred stock would include capitalization of earnings by way of stock dividends.

4) There is a certain amount of "double counting" because of the inclusion of all holding companies and their subsidiaries. For example, the full balance sheet of Aluminium Ltd is included as well as the full balance sheet of the Aluminum Company of Canada. The "net investment in subsidiaries and affiliates" of $7.5 billion can be related to the increase in "other liabilities" of $6.8 billion and the rise in equity of $8.5 billion.

5) The companies include wholly owned subsidiaries of foreign concerns, whose financial requirements have, in large measure, been supplied by non-residents. The pattern of financing may well differ from that of domestic companies.

4. Subject to these qualifications the table indicates that 38% of the total application of funds was derived from the issuance of long-term debt and equity securities, this proportion being fairly evenly divided between the two.

5. A further qualification, however, is that arising from changes in the relative importance of certain types of business. For example, the group comprising finance, insurance and real estate (which does not include the chartered banks and insurance companies as these are not tabulated) has grown at an above average rate and in 1959 possessed approximately a quarter of the total assets of all fully tabulated companies. This group accounted for half of the net investment in subsidiary and affiliated companies over the ten year period, for 42% of the increase in net working capital and 37% of the increase in debt. Debt represents a higher proportion of capitalization for these companies than for business in general. This applies also to utilities, for which there has been a considerable amount of debt financing in the past five years, partly in connection with the establishment of new natural gas transmission and distribution companies.

6. It is therefore informative to look briefly at that important and reasonably consistent group of companies engaged primarily in manufacturing. Here, of the total applications of $14.1 billion over the period 1949-59, 60% was derived from internally generated funds, 13.5% from "other liabilities", 12% from the issuance of debt and 14.5% from common and preferred stock.

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TABLE II
SOURCE AND APPLICATION OF FUNDS IN MANUFACTURING 1949-59.

	($ billions)
Application	
Increase in net working capital	2.9
Increase in gross fixed assets	9.1
Net investment in subsidiaries and affiliates	1.9
Increase in other assets	.2
Total applications	14.1
Sources	
Depreciation, depletion, etc.	4.1
Retained earnings and other surplus	4.3
Total internal sources	8.4
Other liabilities	1.9
Debt	1.7
Equity (preferred and common stock)	2.1
	14.1

7. From the more detailed data published on manufacturing in the Taxation Statistics it is interesting to note that capital expenditures over the ten year period amounted to $11 billion - nearly $2 billion more than the net increase in fixed assets as shown in the balance sheets - while capital cost allowances claimed for tax purposes totalled $6.7 billion - $2,6 billion more than the increase in depreciation reserves shown in the balance sheets. In effect, capital cost allowances were equivalent to 60% of capital outlays during the period.

8. Reflecting the important contribution of internally generated funds, there has been very little weakening in the financial structure of manufacturing companies over the period under review. The working capital ratio, which was 3 in 1949, was 2.75 in 1959; net tangible assets were 8.5 times debt compared with 6 times in 1959; and debt constituted 12% of capitalization as against 17%.

9. Nevertheless, the trend towards a higher proportion of debt in the structure of capitalization is apparent. The reasons, too, are obvious. In some cases, particularly with smaller companies, there is a desire not to dilute ownership of the company. The leverage benefits to common shareholders when earnings are on a generally rising trend, and when return on investment is greater than the cost of servicing debt, favour the issuance of debt within the limits imposed by financial soundness. There are generally accepted rules of thumb in the financial community, developed through experience and which are usually incorporated as covenants in trust deeds, that set these limits. They naturally vary from industry to industry, but in general it can be said that for manufacturing companies it is not considered desirable for debt to represent more than 40% of total capitalization, while for utilities the proportion should not generally exceed 60% (although in

certain special cases it could with safety be higher). Similarly interest charges in most cases should be covered at least 3 to 5 times by earnings after depreciation, but for utilities, because of the greater stability of earnings, a 2 to 2 1/2 times coverage may be sufficient.

10. Aside from the factor of leverage there is the further element of cost. Since interest payments may be deducted from corporate income for tax purposes, whereas dividends are not, the cost of issuing debt has been noticeably lower throughout the postwar period than the cost of raising funds through the issue of preferred or common stock. The higher the rate of corporate income tax, the greater is the cost differential. In the late 1920's, for example, taxes amounted to only 10% or less of corporate profits, and with the difference between bond and stock yields at that time it was cheaper to issue common stock (although this did not prevent extensive debt financing). Today the tax rate is 50% to 53%, and a company can afford to pay interest at the rate of 8% before the net cost exceeds a dividend rate on shares of 4%. Should the tax rate fall to 40%, then an interest rate of 6.7% would be equivalent to a dividend rate of 4%. It would be easier to justify the issuance of stock under such conditions.

11. There has been a pronounced tendency over the years for the corporate income tax rate to creep upward. The ramifications of this are many and varied, but the incentive it provides for unsound corporate financing is one which, we feel, should be carefully considered. It would obviously be impractical to suggest reducing the corporate tax without at the same time pointing out other areas where increased tax revenues might be obtained or expenditures reduced. This could only be done in a comprehensive analysis of the situation of Canadian taxation. We understand that Queen's University is engaged in a study of this nature at the present time.

12. It is not surprising to find considerable difference in financial structure according to the size of companies. As shown by the following table constructed from the Taxation Statistics for the year 1959, smaller firms have relatively

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more recourse to bank financing than the larger; debt constitutes a smaller proportion of capitalization (and much of the debt is represented by mortgages); stock is of much greater importance; and a higher proportion of net profit is retained. These differences reflect the greater ease with which large, mature companies with long established records of earnings can obtain funds, particularly debt funds, in the market. To some extent they may also reflect the different industries typical of the various asset sizes.

TABLE III

Financial Structure of Manufacturing Companies By Size of Total Assets - 1959

Companies with Assets	Total Assets ($ billions)	Working Capital Ratio	% Composition of Capitalization				
			Debt	Preferred	Common Stk	Surplus	Total
Less than $100,000	236.6	1.26	6.5%	21.9%	48.0%	23.6%	100%
100 - 250,000	544.4	1.49	8.7	17.2	23.3	50.8	100%
250 - 500,000	622.5	1.61	7.4	16.4	20.9	55.3	100%
500 - 1,000,000	859.5	1.72	6.3	10.1	21.6	61.9	100%
1- 5,000,000	2,499.2	2.22	9.8	10.5	18.7	61.0	100%
5- 10,000,000	1,453.5	2.61	10.00	6.4	22.3	61.3	100%
10- 25,000,000	2,140.9	2.96	15.9	7.8	22.6	53.6	100%
25- 100,000,000	4,763.9	2.76	16.1	6.1	26.1	51.7	100%
100,000,000 -over	7,000.1	2.35	22.3	3.9	26.2	47.6	100%

BANK OF CANADA DATA

13. The Taxation Statistics apply to all tabulated companies, whether they are privately owned or public, whether they are wholly-owned subsidiaries of foreign parents, or only partially controlled, and whether they are subsidiaries of Canadian firms or independent. The degree to which they have issued debt, preferred stock or common stock does not therefore necessarily bear any relation to the size or composition of security issues in the capital markets.

14. The Bank of Canada, however, publishes data on net new issues of securities by Canadian companies, including banks. These show that from 1949 to 1960 inclusive $8.8 billion was raised from the issuance of securities, broken down as follows:

Debt	$5.2 billion
Preferred stock	.6
Common stock	3.0

15. Of the amount raised through sale of common stock $390 million represented rights offerings of the chartered banks and $472 million rights offerings of The Bell Telephone Company of Canada. Together these accounted for 28% of the total net new issue of common stocks. Taken in conjunction with the taxation figures, the above show conclusively that the issuance of debt has been much greater than

that of equity securities. The proportion represented by debt has fluctuated considerably from year to year, the high being 76.8% in 1950 and the low 21.2% in 1959 - a year of extreme difficulty in the bond markets. But the average for 1949-56 was 56.3% and for 1957-60 59.5%, indicating very little change from the period of sharp expansion to that of decline in business capital expenditures.

16. Rights offerings have been a frequent method of raising funds through common stock (the main reason being that the preemptive rights of the shareholders are protected) and these probably account for a considerable proportion of the remainder of the corporate stock financing. There have, however, been a number of new large companies formed during the past decade, notably among natural gas utilities and finance companies, which have had public issues of common stock, and particularly in recent years a number of smaller firms have come to the market. There have also been new companies established by European interests with Canadian participation usually by means of participating preferred shares. On the other hand, other companies have been acquired by larger firms and their shares either have disappeared entirely or the amount outstanding in the hands of the public has been reduced substantially. One industry in which this has occurred to a considerable degree is pulp and paper. Thus the number of stocks listed on the Toronto Stock Exchange rose only from 867 at the end of 1948 to 1,117 at the end of 1961, and most of this increase was in junior mining and petroleum companies.

UNDERWRITING

17. For a description of the underwriting process in Canada, the following extract from "Securities Regulation in Canada" by Professor J.Peter Williamson is essentially accurate:

18. " Once the underwriter is chosen, an 'underwriting agreement' is drawn up. Some of the features of this contract are fairly standard. It will usually take the form of a letter from the underwriter to the issuer. The letter will describe the security involved and constitute an offer to purchase the issue under certain conditions. The price will probably not be made definite until just before the underwriter signs the letter and the issuer signs an acceptance, and this will not take place until just before the offer to the public. However, a price range may be tentatively established at an early stage.

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19. " The conditions set forth in the letter will include some standard ones. The issuer will be required to fulfil all legal requirements as to the issue of the securities and as to their offer for sale throughout Canada (often excepting Newfoundland and Prince Edward Island). This will include compliance with the applicable companies act and the provincial securities acts. The underwriter's commitment will be subject to a favourable opinion of its counsel as to the legality of the issue and its sale, and the issuer will probably pay for this opinion.

20. " The accuracy of the prospectus will be made the issuer's responsibility. The companies acts and securities acts, where they impose liability to purchasers for omissions and misstatements in a prospectus, sometimes make the underwriters equally liable with the issuer. Hence, the underwriting agreement will include a warranty from the issuer to the underwriter that the information in the prospectus is true and that the issuer consents to its use, and an indemnity to protect the underwriter from the consequences of a false statement, omission of a material fact, or stop order issued by any securities commission.

21. " The issuer will be required to furnish whatever financial and statistical information is reasonably necessary for selling purposes, including audited financial statements, if these are appropriate.

22. " Finally, there will be some sort of escape clause, a so-called 'market out' clause. This will give the underwriter an option to terminate the agreement, usually up until the time the prospectus is accepted for filing and a public offering may lawfully begin, in the event of (to quote one such agreement) 'any catastrophe of national or international effect which, in our opinion (that is, the underwriter's opinion), is adverse, or any action, government regulation or other occurrence of any nature whatsoever which, in our opinion, seriously affects or may seriously affect your business or the financial markets'. It is unlikely that the clause will ever be used by the underwriter. It is, after all, the market risk (in a less severe form perhaps) that the underwriter is being paid to take, and except in a real crisis a reputable underwriter will not exercise its escape rights.

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23. " It is normal practice for the issuer to pay its legal expenses and for the underwriter to pay its own counsel. Where one counsel acts for both, the issuer usually pays. It has been the custom for the underwriter to pay for the prospectus, but the current trend is towards the issuer's bearing this expense.

24. " Having negotiated an underwriting agreement, which is as yet unsigned and lacks a final price, the underwriter selects the participants for a banking group. Certain underwriters may be included because the issuer wants them, but the group is more likely to be formed on the basis of long-standing relationship with the principal underwriter. Once a particular banking group has become associated in financing an issuer, the members will expect to be invited to participate in similar future offerings of this same issuer, and the principal underwriter will expect them to take up their proportionate part of these new offerings.

25. " The principal underwriter will be a member of the banking group, and its syndicate manager. The name of the manager will always appear first in the list of underwriters in a prospectus — this is a mark of prestige about which underwriting firms are sensitive. The banking group agreement will consist of a letter from the syndicate manager to each of the group members. Actually 'group agreement' may be a little misleading. There is no agreement among the members; each signs an identical agreement (identical except for the size of the participation) with the manager alone.

26. " The letter from the manager will give a description of the securities (subject to change), refer to the underwriting agreement to be signed, and offer to the prospective banking group member a participation of a specified amount of the issue. Acceptance of the offer will constitute a purchase of the participation from the manager. The banking group agreement and the underwriting agreement are usually signed the same day. The syndicate manager will often sign the agreement with the issuer in the morning and then obtain an oral acceptance by telephone from each banking group member, who will mail a written acceptance the same day.

27. " The entire letter constituting the banking group agreement is pretty much standard, apart from the description of the securities. The manager will reserve a specified percentage of each member's participation, for sales to 'exempted institutions' (meaning institutional investors, such as insurance companies, whom the other members agree not to solicit) and to a selling group. These sales are handled exclusively by the manager, selling for the accounts of the banking group members. The remainder of a member's participation will be sold through its own facilities.

28. " The offering prices will be set out -- tentatively, until the offering day -- and depending on the kind of securities offered, these may include prices to the public, to exempted institutions, to various dealers, and to banking group members. And the letter will specify the date on which the member is required to take delivery of its securities and pay for them.

29. " Expenses of the issue are borne by the members in proportion to their participations, and profits on sales to dealers and institutions are split in the same way.

30. " The syndicate manager usually reserves the right to 'over-allot' sales to exempted institutions and to the selling group, up to 10 per cent of the total offering, and to cover by purchasing on the market. What this means is that the syndicate manager may 'stabilize' the market by allotting more than the portion of the issue specifically withheld for institutions and the selling group, and filling the extra orders by purchasing on the market and supporting the price. The other members of the selling group, of course, have agreed not to solicit the exempted institutions or the selling group during the period of the banking group agreement. If the over-allotment results in losses, the banking group shares them up to a 10 per cent over-allotment.

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31. " The next stage in the distribution is the selling group. There are two ways in which the syndicate manager may form a selling group. One is simply to make offers to a number of dealers, which, when accepted, become sales. This method may be useful where the selling group is small, but the more common procedure is to invite orders from selected dealers, without making a commitment. The invitation is in the form of a letter, called a 'selling group agreement', from the manager, and is generally sent out on the day registration of the securities is complete. The manager opens a subscription book a day or two after the invitation goes out, and accepts orders or allots proportion of orders if the demand is great.

32. " As an example, the prices on a bond purchased at 97 by the manager might be:

Retail price	$100.00
Price to exempted institutions	100.00
Price to trust companies for resale to clients at the retail price	99.75
Price to casual dealers	99.25
Price to selling group members	98.50
Draw-down price to banking group members, and selling group members	98.50
Cost to banking group members	97.75

The difference between the $97.75 cost to Banking Group Members and the $98.50 draw-down price is an amount withheld by the syndicate manager to cover the expenses of the issue. Any balance of this 'holdback' not required for expenses is returned to the members. The price concession to trust companies would apply only in Quebec, where such concessions are legal.

33. " The selling group agreement, like the banking group agreement, follows a standard form. The manager signs the letter to the dealers as agent for the banking group, so that whatever contract results is between a dealer and the group. After describing the issue, the letter offers to include the addressee in a selling group, and there is a place provided for the dealer to sign in acceptance of this offer, which imposes certain obligations on him (these are discussed below). However, as to the extent of his participation, only an invitation is made and the banking group is not bound to deliver securities until it has accepted the dealer's order.

34. " The selling group agreement repeats much of the banking group agreement, including a schedule of prices. The members of the selling group are required to comply with securities legislation, and specifically to agree not to solicit orders in the provinces where the securities will not be registered or where the dealer is not qualified to do business (nor to solicit in the United States, unless the securities are to be registered there). "

36. In addition to "firm commitment underwriting", issues may be privately placed with one or more institutions in Canada or the United States. In this case the investment dealer acts simply as agent for the issuer, or may do nothing more than bring two parties together, using his knowledge of the investment policies of various institutions. For these services the dealer usually receives a moderate commission which will probably range between 1/4 and 1 1/2% depending on how much work has been involved and the size of the issue. Moreover, no registration statement is required for private placements with institutions. Hence the expenses of issue are lower than for a public offering. On the other hand, a slightly higher yield must usually be given to the lender and the covenants may be more restrictive, while the company does not derive the advantage of more widespread ownership (e.g. the public relations aspect, and public familiarity with the company which may be helpful in subsequent issues of securities).

37. Occasionally, and particularly in the case of small issues, an underwriting may be on a "best efforts" basis, whereby the dealer undertakes to use his best efforts to sell the securities as an agent of the issuer, receiving a straight commission on sales made.

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38. A major underwriter has a twofold responsibility. One is to provide sound advice to the companies for which it acts as fiscal agent and underwrite securities on the best terms and lowest over-all costs consistent with the issuing company's financial position and the condition of the securities markets. But an underwriter also has an established clientele to whom it sells the new issues that it underwrites or in which it participates. Its reputation as an underwriter is in part determined by its "placement" power. And it has a responsibility to its clients to correctly represent the quality of an issue and ensure that the return to the investor is commensurate with the degree of risk taken. As further protection to its clients and to its own reputation, the underwriting house will usually maintain a watching brief on the progress of a company for which it acts as fiscal agent, frequently to the extent of being represented on the board of directors. If a company does run into difficulties the underwriter often plays an active role in overcoming them, occasionally placing its own resources behind the credit of the company if the need arises.

DISTRIBUTION OF BONDS

TABLE III-A
Estimated distribution of holdings -
Corporate and other non-Government Bonds
(dollar figures in thousands)

Holder	1959 Principal Amount	1959 % of total	1954 Principal Amount	1954 % of total	Change 1954/9
1. Bank of Canada	59	1	11		+ 48
2. Chartered Banks	512	7	353		+159
3. Provincial Governments	24	-	50		- 26
4. Municipal Governments	15	-	1		+ 14
5. Life Insurance Companies	1924	27	1407	33	+517
6. Other Insurance Companies	132	2	64		+ 68
7. Quebec Savings Banks	21	-	16		+ 5
8. Trust & Mortgage Loan Co.	160	2	81		+ 79
9. Pension Plans	473	7	742		+1062
10. All other Residents	1331	19			
11. Total Residents	4651	65	2725	65	+1926
12. Non Resident	2479	35	1498	35	+ 981
	7130	100	4223	100	+2907

Source: Bank of Canada Statistical Summary Supplement 1960.

38A. From the foregoing it can be observed that (1) domestic institutions and pension funds comprise the largest market for corporate bonds, accounting in 1959 for some $3,320 millions principal amount equivalent to roughly 46.5% of outstanding corporate debt obligations, (2) the life insurance industry is the largest single market for corporate bonds, and (3) non-residents have acquired roughly 35% of Canadian corporate and other bonds. The (life) insurance industry in 1959 owned $2,056 millions principal amount of corporate bonds, equivalent to approximately 29% of the total outstanding principal amount of Canadian corporate and other bonds. In 1954 however, this industry owned $1,471 millions principal amount of corporate bonds, equivalent at that time to roughly 35% of the total outstanding principal amount of Canadian corporate and other non-government bonds.

38B. This trend is significant for the investment dealer as it points out that problems inherent in the distribution of corporate bonds are becoming more complex; for though there are several large buyers, in itself a factor tending to somewhat simplify the distribution process, the reduction in the leading role of the insurance industry requires the investment dealer to turn to several other sources.

38C. In passing it is worth noting that the insurance industry in the United States of America is a much more dominant factor in the acquisition of corporate bonds than the life insurance industry is in Canada. To this extent therefore the Canadian investment dealer has a more complex distribution problem than his U.S. competitor.

38D. Table III-A, pointing out that 35% of Canadian corporate and other bonds are in the hands of non-residents, indicates the desirability of access to foreign capital markets if the investment dealer is to continue to fulfill his functions of raising capital funds for business enterprise.

UNDERWRITING COSTS

39. The cost of issuing securities varies according to two main factors - size and degree of risk. With regard to size there are certain expenses involved such as legal fees, preparation of prospectus, research and sales expenses which are more or less fixed regardless of the size of an issue. Thus the smaller the issue, the larger is the relative burden of these charges. In the matter of risk, the underwriter assumes a greater chance of loss on securities of small or new companies, or those with unstable earnings records, than with, for example, a well established utility; the chance of loss is also greater in the underwriting of junior securities, particularly common stocks, than in the case of first mortgage bonds. These factors account in large measure for the differences in costs shown in the following table, derived from reports submitted by members of the Investment Dealers' Association.

TABLE IV

	Number of Members Reporting	Percentages Arithmetic Average	Median	Range
Average gross mark up (as a per cent of cost) on -				
Common stock issues -				
(a) under $3 million	24	8.43	9.09	2.00-14.00
(b) over $3 million	7	6.98	6.38	5.00-10.00
Preferred stock -				
(a) under $3 million	14	6.05	4.77	3.50-11.11
(b) over $3 million	6	4.75	4.00	3.50-6.50
Bonds and Debentures				
(a) under $3 million	33	4.62	4.90	1.00-10.00
(b) over $3 million	20	2.82	2.85	.50- 5.00

COMPARISON WITH THE UNITED STATES

40. In general, and this belief arises in good part from our experience in joint underwritings with U.S.firms on Canadian issues, we would say that costs are very similar in the two countries, but generally somewhat higher in Canada for large issues and somewhat lower for small issues. A study by the Securities and Exchange Commission in 1957 produced the following data:

TABLE V

United States
Underwriter's Compensation % of Gross Proceeds of New Issue
(1951, 1953 and 1955)

($ millions) Size of Issue	Common Stock	Preferred Stock	Bonds, Notes, Debentures
under .5	27.15%	-	-
.5 - .9	21.76	12.63	11.49
1 - 1.9	13.58	8.07	8.17
2 - 4.9	9.97	4.88	3.78
5 - 9.9	6.17	3.72	1.83
10 - 19.9	4.66	2.92	1.52
20 - 49.9	5.37	3.20	1.33
50 and over	-	2.51	1.19

N.B. The percentages given above are the arithmetic averages in each classification.

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41. The data in Table V are subdivided into more classes than the information requested from members of the I.D.A, and show clearly the tendency for underwriting costs to decline with the size of the issue and the type of security issued. Other data in the S.E.C. study also show a correlation between the size of the issuing company and the underwriting costs.

42. In comparing Table IV with Table V, it must be noted that the former is the gross mark up as a percentage of cost, whereas the latter is expressed as a percentage of the issuing price. If the Canadian data were on a comparable basis with the U.S., the percentages would therefore be somewhat lower. Even so, it is apparent that in issues of under $3 millions underwriting costs are lower in Canada than in the U.S., (in the case of common stock particularly they are significantly lower), while for larger issues they are a point or so higher.

43. Further support for this conclusion can be found in a comparison of the spread between yield to buyer and yield cost to company of utility issues rated by Moody's. In 1959 and 1960 such spreads on issues by U.S. utilities rated by Moody's as BA or BAA ranged from .10% to .17%; issues of Canadian utilities with similar ratings in recent years have had spreads ranging from .11% to .17% (in both cases the issues surveyed were in excess of $15 million). A further sample of large issues of well regarded Canadian companies, but not rated by Moody's, showed spreads from .16% to .18%. In this comparison we have used "yield spread" as this was the information supplied in Moody's Public Utilities Manual.

44. There are, of course, fundamental differences in the nature of the markets in the two countries. The very size of the major financial institutions in the United States makes it possible for issues even as large as $50 million to be placed with only a handful of buyers, and retail distribution of bonds to individuals is the exception rather than the rule. In Canada, by contrast, most issues are sold to a large number of institutions and individuals. The costs of distribution are therefore considerably higher in this country, and do not fall as rapidly with size as in the United States.

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COMPETITIVE BIDDING versus NEGOTIATED SALES

45. The comparison between comparable U.S. and Canadian utilities in Paragraph 43 is interesting for in many cases U.S. utilities are compelled by the regulatory authorities to call for competitive bids on new debt security issues, whereas in Canada the practice amongst non-Government companies is to have negotiated issues with fiscal agents.

46. The theory behind competitive bidding in new issues, as with other types of contract, is that competition is likely to result in the most favourable price to the seller. In some instances this probably holds true. There is reason to believe, however, that this may not be so in the case of security issues, judging by the experience in the United States.

47. From the data supplied in Moody's Public Utility Manual, a comparison was made of negotiated sales and competitive tenders, taking issues with the same rating, issued at roughly the same time of year (i.e. within the same month) and of approximately the same size. In total, 16 comparable pairs of issues that fitted these requirements during 1959 and 1960 were found. In 11 of these comparisons both the yield to the public and the yield cost to the borrowing company were lower in the case of negotiated sales than in competitive bidding, while in 5 they were higher. The spread between yield to buyer and yield cost to borrower, representing the underwriting spread, was lower for negotiated sales in six comparisons, the same in 3 and higher in 7. With regard to the degree of difference, in the 11 cases where the yield cost to the borrowing company was lower for negotiated sales, the average difference from competitive bids was .29 basis points; in the five cases where competitive bids showed a lower yield cost, the difference averaged .11 basis points.

48. It would perhaps be unwise to draw strong conclusions from this limited survey, but there are good reasons why negotiated sales should in fact be cheaper for the issuing company than competitive bids. For a fiscal agent maintains a continuous relationship with a company. It is in a position to advise on the nature and timing of new issues, can assist in the preparation of the prospectus

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48. (cont'd)

and can test the market ahead of time in order to ensure that the terms of the issue will be attractive to potential buyers, but not so attractive as to add unnecessarily to the borrower's cost. The fiscal agent tends to serve as an adviser in other matters relating to corporation finance, such as the temporary investment of funds and purchase of bonds for sinking funds, and also maintains markets for securities between issues. Where competitive bidding is followed, on the other hand, the terms of an issue are drawn up by the company, although sometimes a consultant is hired to advise on the issue and prepare supporting data, and dealers are required to bid on short notice without benefit of advance preparation and without a full and detailed knowledge of the company's position. Particularly when interest rates are on a rising trend, dealers therefore tend to allow fully for unforeseen problems when submitting bids.

48 A. The considered opinion of Judge Medina on this effect of competitive bidding was that:

> " Fundamentally, the contentions of government counsel on this and other phases of the case stem from a misconception of the investment banking business. And yet the advantages to an issuer, which are incidents of a continuing relationship with a good investment banker, seem too obvious for comment, In every business the customer feels that there are cogent reasons why he should continue with the firm which has rendered good service in the past. But with a series of security issues, the saving in the time and labor of the officers and employees of an issuer, which would have to be spent in teaching a new investment banker the intricacies of the business, and the financial set up of the company, are a matter of real consequence; and it must not be forgotten that many of the matters to be discussed are of such a character that company officials desire to have such conversations only with those whom they trust, and in whose integrity and competence they have complete confidence. "

49. As mentioned previously, it is the practice in Canada for most companies to have fiscal agents. There is nothing to prevent a company from calling for bids on its issues should it so desire, but it is generally recognized that any advantages of this are outweighed by the disadvantages.

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AMORTIZATION OF UNDERWRITING EXPENSES

50. When a company issues debt securities, the usual practice is to capitalize the difference between the par value of the debt issued and the net amount received from the underwriters, and gradually write off the bond discount and expenses so created by appropriate charges to earnings over the life of the security or at once to earned surplus. Such charges, however, are not deductible from income for tax purposes. To the extent that the difference between par value and net receipts of funds represents the sale of bonds to the public at less than par value, it is reasonable that the amortization charges should not be tax deductible. But to the extent that it represents the underwriters' commission, we feel very strongly that it is fair and reasonable that the charges should be allowed as a deductible item, for the cost of raising funds is just as much a cost of doing business as, for example, the fee paid to an engineering consultant. We therefore suggest that the income tax legislation be amended so as to permit companies to deduct underwriting costs in arriving at taxable income.

SECURITIES LEGISLATION

51. Securities regulation in Canada involves ten provincial Securities Acts, various provincial Companies Acts, the Dominion Companies Act, the Ontario Corporations Information Act and the Quebec Companies Information Act. The movement towards bringing some uniformity and order to this mass of legislation is proceeding slowly but progress has been noted. For example, the provinces are currently studying a uniform Companies Act; four provinces now have identical, or nearly identical, Securities Acts; and it is understood that two other provinces are in the process of adopting very similar Securities Acts.

52. The Association has for some years been suggesting to provincial officials the advisability and the advantages to the provinces and the investing public of enacting uniform securities legislation and of administering such legislation in a uniform manner and observes that definite progress has been achieved in this regard. The Association recommends that steps should be taken whereby all provinces will expedite registration of new issues of investment securities on a uniform basis.

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53. The Association has noted with interest a proposal that a Federal Securities Act and a Federal Securities Commission be established. The United States has two Federal Acts: The Securities Act of 1933, which is a full disclosure statute permitting the sale of a security provided specified information is given to the purchaser, and The Securities Exchange Act of 1934, which is primarily concerned with trading in securities after the primary offering. The 1934 Act regulates stock exchanges, the registration of brokers and dealers and imposes reporting, proxy and trading conditions relating to securities listed on stock exchanges. It should be observed that, in addition to these two Federal Statutes, 48 states also have securities legislation.

54. It would appear to the Association that if a Federal Securities Act and Commission were ever to come into being in Canada they would be superimposed on but would not replace the existing provincial securities legislation and commissions. The Association recommends that S.E.C.-type legislation not be established in Canada and that the Royal Commission take note of the progress which has already been achieved towards uniform securities legislation uniformly administered as well as the work in this connection which is presently in progress.

55. However, as the acts now stand, it is necessary that a complete prospectus be in the hands of a prospective buyer before an issue can be sold to him. Exceptions to this rule are the chartered banks, life insurance companies and trust companies. It would be helpful if the practice in the United States of using a "red herring" could be followed here. This is essentially a preliminary prospectus, with all the details except price and yield, which is distributed pending approval of the regulatory authorities. The institutions and other prospective buyers can study this at their leisure and indicate, subject to approval of the prospectus by the authorities and to the terms of the issue being satisfactory, how much they would be prepared to purchase. This makes for more orderly marketing of the issue, as it gives the syndicate manager an indication of the requirements of major buyers and participating dealers, and at the same time gives the buyer more time in which to appraise the issue, without in any way negating the purpose of the present requirement that a buyer see a final prospectus before he buys. We would recommend that the various acts be amended to permit this practice in Canada.

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56. It would also be helpful if all regulations affecting the underwriting and sale of securities were promulated to the Investment Dealers' Association, who would then inform all its members. At the present time, regulations are frequently not publicized and they are not discovered, or their import not fully appreciated, until the regulatory authorities bring them to the attention of an underwriter in a particular case. This, too, can result in delay in the scheduling of a new issue.

57. The expropriation of electric utilities by provinces have in the past and can in the future provide a heavy blow to the very foundations of Canadian justice. In the case of the B.C. Electric Company, the IDAC strongly asserted that in the interests of justice provision should be made for arbitration and independent appraisal of expropriated assets. It would seem desirable that insofar as is possible the justification for expropriating utilities should be removed. It thus seems essential that the Commission should give careful consideration to this question with a view to making a recommendation that the Federal Government do all that is in its power to devise means of removing the temptations to expropriate which arise out of the Federal Tax treatment of the provinces. Any such action would contribute to the restoration of the shaken confidence of Canadian and foreign investors in investing in electric utilities in particular and private industry in general.

58. In the matter of mergers and amalgamations there appears to be an absence of adequate safeguards to provide proper protection for what should be the rights of shareholders. Under conditions in which Canada is struggling to compete in world markets mergers may be desirable. As many Canadian businesses are small in comparison to their foreign competitors, certain mergers may well enable Canadian business to compete more efficiently and effectively and foster progress for this country. However, while recognizing the values of mergers or similar amalgamations when soundly conceived and properly organized, the IDAC deplores the so-called "take-over" technique when: (a) the identity of the buying principal is not disclosed; (b) the offer, if for less than 100% of the voting stock, is not made proportionately to all shareholders; (c) the term of the offer is not sufficiently long to give all shareholders reasonable time to consider it.

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59. Speaking generally, a company incorporated under the Companies Act of Canada is the natural vehicle to carry on a corporate enterprise in several provinces and is more attractive to foreign investors than a provincially incorporated company. However, the Act contains certain anomalies which tend to deter the incorporation of companies under its provisions and and create unnecessary delays, expense and inconvenience in connection with the securities of companies which are incorporated under it. It is submitted that the Act should be reviewed with a view to elimination of these anomalies. In particular, it is recommended that private companies be permitted to offer their bonds and debentures to institutional investors, that the redemption and purchase for cancellation of preferred shares be simplified, that, in proper cases, companies incorporated under the Act be exempt from issuing and filing a prospectus in connection with the sale of their securities, that section 128, relating to the compulsory sale of shares, be repealed and that the Act be amended to permit amalgamation of Dominion companies either with other Dominion companies or with companies incorporated under the laws of any one of the provinces.

CORPORATION FINANCE

CONCLUSIONS AND RECOMMENDATIONS FOR THE I.D.A. BRIEF

References

Para. 4,7,8-11 Reflecting the importance of internally generated funds, which appear to have financed approximately 60% of the total applications of funds of Canadian business during the period 1949-59, there has been very little weakening in the financial structure of business. Nevertheless, the trend towards a higher proportion of debt in the structure of capitalization is apparent. Among the factors influencing this is the high rate of corporate income tax, which provides an incentive for unsound financing.

Para. 40-44 Underwriting costs appear to be lower in Canada than in the United States for small issues and somewhat higher for large issues. Because of the different nature of the markets in the two countries, distribution costs do not fall as rapidly with size in Canada as in the United States.

Para. 50 It is recommended that income tax legislation be amended so as to permit companies to deduct underwriting costs in arriving at taxable income.

Para. 54 It is recommended that S.E.C.-type legislation be not established in Canada and that the Commission take note of the progress already achieved towards uniform securities legislation uniformly administered and the work presently in progress to achieve this objective.

Para. 55 It is recommended that the various securities acts be amended so as to permit the distribution of preliminary prospectuses in order that prospective buyers of a new issue can study it at length and indicate, subject to approval of the prospectus by the regulatory authorities and to the terms of the issue being satisfactory, how much they would be prepared to purchase. This practice is followed in the United States. It makes for a more orderly marketing of a new issue and gives the buyer more time in which to appraise it.

Para. 56 It is recommended that all regulations affecting the underwriting and sale of securities be promulated to the Investment Dealers' Association, who could then inform its members.

Para. 57 It is recommended that the Commission examine the important matter of expropriation of electric utilities with a view to recommending that the Federal Government devise means to minimize the temptation to expropriate arising out of Federal Tax treatment of the provinces.

Para. 58 It is suggested the Commission examine shareholders rights in the light of certain recently employed "take-over" techniques.

Para. 59 It is recommended that the Commission examine the Companies Act of Canada with a view to recommending removal of certain anomalies in it which tend to deter the incorporation of companies under its provisions.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX "F"

SECONDARY BOND MARKET

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX F

SECONDARY BOND MARKET

I N D E X

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BRIEF OF THE TRADING FUNCTIONS COMMITTEE

For the purpose of this brief the following definitions will apply:

Broker	-	Member of a recognized stock exchange.
Dealer	-	Member of the Investment Dealers Association of Canada or others such as Chartered Banks who participate in the secondary bond market.
Agent	-	Dealer who acts as a intermediary between buyer and seller at an established price and receives a commission for his services.
Principal	-	A dealer who accepts liability for his own account through either the purchase or sale of securities. It should be noted that dealers customarily act both as agent and principal but not in the same transaction and any purchase or sale must be designated as one or the other.
Money Market Dealer	-	One of 14 member dealers of the Investment Dealers Association who have been extended lines of credit by the Bank of Canada to facilitate their functions in the handling of Government of Canada Treasury Bills, and Government of Canada and Guaranteed Bonds with a maturity of less than 3 years.
Depth	-	The secondary market has depth when there are actual or easily accessible orders both above and below the current level of prices. A market lacking depth would be shallow.
Breadth	-	The secondary market has breadth when orders are in volume and from widely divergent groups of investors. A market lacking breadth would be narrow.
Resilience	-	The secondary market has resilience when new orders come into the market in volume in response to perceptible changes in yield. A synonym would be elastic and a market lacking resilience would be inelastic.
Thin	-	Describes a market which lacks depth, breadth and resilience.
Position	-	The liability which a firm has incurred in any security. The total of all positions of a firm would make up that firm's <u>inventory</u>. A <u>long position</u> is one in which the firm has purchased securities for future sale. A <u>short position</u> is one in which the firm has sold securities which it does not currently own but which are to be purchased at a later date.

I. THE NEED FOR A SECONDARY MARKET

1. It is inherent in the nature of a highly-developed capitalist society that there must be a mechanism by which capital may change hands. The process of transferring new capital from a saver to a user takes place in what is known as a primary market; while the transfer of outstanding (previously issued) securities from one investor to another takes place in the secondary market. In this brief we are concerned with the secondary bond market and will mention primary markets only where they impinge on the main subject.

2. The importance of the secondary market to the continuing development of the economy cannot be over-emphasized, for this market is a vital factor in regulating the smooth and efficient flow of funds from savers to users. There is no doubt that lack of secondary markets would increase the cost of capital and, by inhibiting the mobility of funds, reduce the ability of the country to finance its development from domestic sources.

3. Secondary markets provide two basic functions - value perspective and liquidity - on which the system depends for the orderly use of capital. Through the secondary market, a level of prices is established which gives borrowers a reliable indication of the cost of capital and lenders an estimate of the rate of return they might expect from the type and terms of security being offered. This method provides the logical means of arriving at fair value for both parties. By establishing relative values at any point in time, secondary markets assist in establishing the order of preference in which prospective issuers will be allotted funds. The market is, therefore, an important factor in regulating the flow of capital throughout the economy.

4. The degree of liquidity which any new issue of bonds is likely to enjoy is second only to fair pricing in the minds of most investors. The secondary market provides the yardstick by which liquidity may be gauged from the behaviour of comparable outstanding issues. Investors having mandatory requirement for the return of cash at specific dates,purchase securities tailored to their needs. Others, who are unaware at time of purchase of future requirements for the return of cash, may purchase bonds having an intermediate or long term maturity in order to obtain the greater yield

usually available. Conditions may arise whereby these investors desire to sell their holdings and the secondary market provides the means of so doing. Without liquidity, investors would be more reluctant to advance funds, borrowing costs would be substantially higher, and users would pay an unduly high price for capital. Markets also afford users the opportunity to carry out Sinking Fund and Purchase Fund operations at fair prices.

5. The importance of liquidity in reducing the costs of borrowing is made evident by comparison with mortgage rates in Canada. In the majority of cases, the cost of raising capital through a conventional mortgage is higher than that which would apply to an issue of bonds or debentures by the same issuer. Although other additional service charges must be considered, it is generally conceded that the higher interest cost of mortgages is largely due to the lack of an effective secondary market in which the investor may regain his funds for other purposes.

6. Open market purchases or sales by Bank of Canada in accordance with its interpretation of requirements for the conduct of monetary policy and other necessary movements of securities are greatly facilitated by the secondary market. Chartered Banks, Trust Companies, Corporations and individuals also rely on the market for portfolio adjustment.

7. The figures shown below compare total new bond issues in Canada during 1961 with the additional volume of secondary market sales made by members of the I.D.A.C. during their fiscal year. Not included are sales made by Bank of Canada, Chartered Banks or other participants in the secondary market.

TABLE 1

Primary Market Sales vs. Secondary Market Sales, 1961
000's of Dollars

		Primary Market(1) Sales	Secondary Market(2) Sales
Treasury Bills		6,240,000	6,142,159(4)
Canadas and Guarantees:	under 3 yrs.	1,325,000(3)	4,618,820
	over 3 yrs.	875,000(3)	1,961,748
Provincials and Guarantees:	public sale	738,051	1,289,004
	private sale	9,000	
	Parity & Savings Bonds	204,645	
Municipals		462,180±	368,087
Corporate,	public sale	418,460	1,400,230
	private sale	248,050	
		10,520,386	15,780,048
	Less	1,015,000(3)	
		9,505,386	

(1) Source: Financial Post Record of Financing in 1961. (January and February, 1962)

(2) Source: I.D.A.C.

(3) Of the Primary Market Sales, the following gross amounts were taken by Bank of Canada and paid for by surrender of other maturing debt. Substantial amounts were later distributed to the public through the secondary market.

Canadas, under 3 years	$440,000,000
Canadas, over 3 years	$575,000,000
	$1,015,000,000

(4) Bills purchased by dealers at Thursday auctions are included. Purchase and re-sale agreements are not shown.

8. Although the secondary market sales of I.D.A.C. members only are shown, the total volume represents 166% of primary market sales. Excluding Treasury Bills the figure would be 295%.

9. It is of interest that approximately 95% of the total recorded volume was handled by 33 dealers who carried inventories of over $1 million. If sales of Treasury Bills were excluded the proportion would be about 92%. (Reference Table 3)

II. ORIGIN OF SECONDARY MARKETS IN CANADA

10. At the turn of the century there was to all intents and purposes no broad securities market in Canada and, in fact, as far as debt securities were concerned this condition existed up to the advent of the First World War. Prior to 1914 almost all Canadian capital requirements were met by imports from the United Kingdom and, after 1914, by imports from the United States. It was not until the U.S. market was restricted by the entry of the Americans into the war in 1917 that Canadians were faced with financing the major share of their own capital requirements. During the period prior to 1917 there were markets being made in Canadian debt securities in London and New York but lack of an efficient market system in Canada, coupled with poor communications, did not provide the domestic investor with a satisfactory means of buying or selling bonds. The Victory loans, first offered to the public in 1917, brought about the necessity for the establishment of a secondary market as a substantial volume of bonds had been placed domestically.

11. As early as 1914, the Bond Dealers Section of the Toronto Board of Trade had been formed and in 1916 dealers in Montreal became interested in an association which resulted in the amalgamation of the two into the Bond Dealers Association of Canada. This group, the predecessor of the present I.D.A.C., originally consisted of 32 dealers from Montreal and Toronto. By 1919 the Association had grown to 72 members, including some from Western Canada and the Maritimes, and an active secondary market had begun to develop. This market developed actively during the 1920's and 1930's but was relatively stagnant during World War II. However, with the enormous expansion of the economy in the post-war period, the demand for capital grew very quickly, resulting in a highly-developed, vigorous secondary bond market.

III. THE SECONDARY BOND MARKET TODAY

(a) How Markets are Made

12. Those who normally participate in the secondary bond market as it is presently constituted are members of the I.D.A.C.; Trading Departments of the Chartered Banks and the Securities Department of Bank of Canada. In addition, members of the various Stock Exchanges in Canada and a number of

other brokers and/or dealers licensed to deal in securities with the public by Provincial Securities Commissions may participate but experience has shown limited activity by these groups. The number in each category:

TABLE 2

Members of the I.D.A.C.		185
Chartered Banks		8
Bank of Canada		1
	TOTAL	194
Members of Toronto, Montreal and Canadian Stock Exchanges (non I.D.A.C.)		45
Other licensed brokers and/or dealers, not included above (1)		200-250

(1) Source: I.D.A.C.

13. These dealers participate to a widely varying degree. The large majority makes use of the market only to execute orders obtained from clients and in most cases should therefore be described as agents. Others, while acting as agent in certain transactions, normally act as principals, buying and selling for their own account. From the results of a survey based on figures for 1961, presented in Table 3, there are 16 dealers who customarily maintained total positions in excess of $5,000,000 and 17 dealers whose positions were between $1,000,000 and $5,000,000. These dealers are, generally speaking, responsible for the origination and maintenance of secondary market levels. It is only through the willingness of such dealers to assume liabilities for their own risk that a continuing market without unduly sharp fluctuations can be achieved.

14. Table 4 summarizes inventory positions of members on a quarterly basis during 1961 by class of securities. Both long and short positions are shown and it is of interest to note the frequency with which short positions occur.

15. Over the years the efforts of dealers to achieve a proper mechanism for the handling of business has resulted in a program of careful selection and training of trading personnel, development and application of equipment, substantial expenditure for these facilities and the continual refinement of regulations and ethical practices. Each dealer employs from

CATEGORIES OF MEMBERS OF THE I.D.A.C. - BY SIZE OF AVERAGE QUARTERLY INVENTORY FOR 1961

- INCLUDING RELATED SALES VOLUME

TABLE 3

Average Quarterly Inventory	Federal Treasury Bills		Canadas & Guarantee Under 3 Years		Canada & Guarantees Over 3 Years		Provincial & Guarantees		Municipals, Schools & Hospitals		Corp. Bond & Deb. excluding Commercial Paper		TOTALS	
$	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales vol Millions of $'s	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales Vol Millions of $'s	No. of Members	Combined Sales Vol. M Mln $'s
0 - 24,999	168	36	133	99	128	186	133	107	139	44	119	94	65	187
25,000 - 99,999	-	-	14	30	20	97	19	25	22	46	38	85	35	138
100,000 -499,999	3	44	11	109	23	344	19	265	18	111	19	327	44	310
500,000 -999,999	-	-	9	178	6	259	5	171	4	77	2	47	8	161
1,000,000 -4,999,999	3	460	8	652	8	1076	9	721	2	90	7	827	17	1067
Over 5,000,000	11	5602	10	3551	-	-	-	-	-	-			16	14066
TOTALS	185	6142	185	4619	185	1962	185	1289	185	368	185	1400	185	15929
											Less Commercial & Finance Co. Paper			149
														15780

Source: I.D.A.C. Survey of Members, 1962

TABLE 4

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA
SUMMARY OF REPORTS BY MEMBERS
SCHEDULE B
INVENTORY OF FIXED INCOME SECURITIES HELD BY MEMBERS

Notes 1. This summary shows total inventory of fixed income securities held by Members during the calendar year 1961 on a quarterly basis.
2. Securities owned by firm and held outside of Canada are not included.
3. Unsold balances of new issues in primary distribution are not included.
4. Members' portions of joint accounts are included.
5. Inventory is shown in thousands of dollars.
6. Short positions are indicated by the letter (s) at left of figure.

Type of Security	33 Nat'l & other major positioning houses — Inventory (thousands of dollars)					Remaining houses — Inventory (thousands of dollars)					Total — Inventory (thousands of dollars)				
	March 31,1961	June 30,1961	September 30, 1961	December 31, 1961	Average	March 31, 1961	June 30, 1961	Sept. 30 1961	Dec. 31 1961	Average	March 31 1961	June 30,1961	Sept.30 1961	Dec. 31 1961	Average
Fed. Treas. Bills	(s)5,235 103,703	155,299	(s)11,894 144,839	171,764	(s)4,282 143,900	50			100	38	(s)5,235 103,753	155,299	(s)11,894 144,839	171,864	(s)4,282 143,938
Cdas & Guar. of 3 yrs. or less	117,396	(s)1,148 97,460	(s)1,241 171,800	117,888	(s) 597 126,136	2,787	(s) 75 3,057	3,488	2,141	(s) 19 2,868	120,183	(s)1,223 100,517	(s) 1,241 175,288	120,029	(s) 616 129,004
Cdas & Guar. over 3 yrs.	(s)1,877 20,816	(s) 368 27,050	(s)3,697 23,583	(s)4,979 21,506	(s)2,729 23,236	(s)194 4,877	5,123	(s) 224 2,737	2,280	(s)105 3,756	(s)2,071 25,693	(s) 368 32,173	(s)3,921 26,320	(s)4,979 23,786	(s)2,834 26,992
Prov. & Guar.	23,249	(s) 125 11,852	(s) 184 25,347	26,850	(s) 76 21,824	(s) 9 3,774	(s) 15 1,801	(s) 5 4,075	(s) 18 3,304	(s) 12 3,238	(s) 9 27,023	(s) 140 13,653	(s) 189 29,422	(s) 18 30,154	(s) 88 25,062
Municip., school & hospital debs.	7,616	8,726	4,504	6,774	6,905	(s) 4 4,044	(s) 10 3,227	3,299	(s) 45 3,573	(s) 15 3,536	(s) 4 11,660	(s) 10 11,953	7,803	(s) 45 10,347	(s) 15 10,441
Corp. Bonds & Debs.	22,373	25,368	22,776	30,164	25,170	3,076	(s) 3 4,059	3,921	(s) 9 3,676	(s) 3 3,684	25,449	(s) 3 29,427	26,697	(s) 9 33,840	(s) 3 28,854
Finance & Commercial Paper	2,455	10,343	9,347	31,274	13,355	425	472	(s) 3 630	547	518	2,880	10,815	(s) 3 9,977	31,821	13,873
Total	(s)7,112 297,608	(s)1,641 336,098	(s17,016 402,196	(s)4,979 406,220	(s)7,684 360,526	(s)207 19,033	(s) 103 17,739	(s) 232 18,150	(s) 72 15,621	(s)154 17,638	(s)7,319 316,641	(s)1,744 353,837	(s)17,248 420,346	(s)5,051 421,841	(s)7,838 378,164
No. of Members reporting			33					152					185		

Source: I.D.A.C. Survey of Members, 1962.

1 to 21 trading personnel whose activities are related directly or indirectly to virtually all other departments and employees in the organization. The Trading Department may well be regarded as the nerve centre of a dealer's operations since advice must be sought in this area before any transaction of a primary or secondary nature can be completed.

16. A widespread system of branch operations has been developed by many dealers in Canada and some have established offices in the United States, Great Britain and Europe. Vast networks of private wires, private telephones and various public services are utilized to maintain constant contact with markets both national and international. This system of communications permits pertinent information and market changes to be available nationally within minutes with the result that an investor almost anywhere in Canada may keep abreast of current developments. Adequate and equal service is available almost simultaneously from coast to coast, allowing the industry to draw upon the savings of the nation. Customarily business may be conducted each business day between 9 a.m. and 5 p.m. in each of the time zones. During these hours traders are constantly in contact with other dealers to make their requirements and offerings known. By this method markets are made and matching transactions can be arranged.

17. Actions taken by the people responsible for making secondary bond markets result from their varying interpretations of the information which is available to them. Markets do not remain static for any prolonged period, as investors are constantly on the alert to anticipate changing conditions which may or may not come to pass but serve to stimulate market activity. In considering bond markets, price levels in themselves are not, generally speaking, of as much significance as the rate of return or yield to maturity. For this reason, prices for all categories of bonds, with the exception of those which carry special features, tend to move in the same direction when changes occur. This frequently results, when interest rates are tending higher, to create an oversupply of securities in the market. This oversupply situation is corrected only when investors feel prices have been reduced to an attractive level. Conversely, when interest rates appear to be working lower, supply dries up until a level is reached which appears in the minds of investors to warrant some liquidation. This process of

adjusting yields to changing conditions is aided and moderated by those dealers who are prepared to anticipate such swings and to take positions for their own account. When a dealer has taken positions in certain issues and orders to buy or sell as the case may be are not forthcoming, he is frequently obliged to hedge his positions in other issues. In this way a determined effort is made to maintain stability. Dealers perform this function in anticipation of overall profitability in this area of their operations. Frequently, of course, losses are sustained through poor judgment or other factors beyond their control. The ability of dealers to hedge long positions is restricted by the limited number of financial institutions who make it a practice to lend bonds at reasonable rates. If a larger number of institutions would make bonds available at competitive rates for this purpose, the functioning of the market would be materially improved. Bank of Canada, Chartered Banks and Trust companies have the necessary facilities to accommodate such borrowers. It is suggested that this practice be broadened and that dealers include the figures of such borrowings in their weekly report to the I.D.A.C.

(b) Regulation of Secondary Markets

18. There is relatively little direct legislative regulation of secondary bond markets when compared, for example, to the regulation of new issues and primary markets. That this area of trading in securities has not attracted restrictive legislation is indicative of the generally high level of integrity with which the dealers have conducted their business. Legislation has, however, been enacted which requires brokers, dealers and salesmen to be licensed before trading with the public.

19. Over the years specific regulations concerning the trading of securities by members of the I.D.A.C. have been developed by the industry as are described in the Blue Book of the Investment Dealers' Association of Canada, Pages 426 to 434 inclusive. Failure to abide by the Regulations is subject to certain penalties as outlined in By-Law No. 8 of The Blue Book. In addition to the penalties for breach of the Regulations, the District and National Business Conduct Committees have broad powers to fine, suspend and/or expel any member (1) whose business conduct or practice is unbecoming a

member or detrimental to the Association or (2) whose financial arrangements, associations or affiliations are objectionable.

20. In addition to the I.D.A.C. whose regulations govern trading by its members across the country, there are Bond Traders Associations in Toronto and Montreal. These Associations operate independently but in close conjunction with the I.D.A.C. and their Trading Regulations are now identical. The Chartered Banks do not hold membership in the I.D.A.C. but Trading Departments are members of the Bond Traders Associations. Consequently, they conduct their business in accord with the I.D.A.C. Regulations. While members of the I.D.A.C. are customers of the Chartered Banks, the latter are also competitors in various areas of the bond business, raising a question of possible conflict of interest. Nevertheless, it is suggested that the Chartered Banks perform a useful service as participants in the secondary market. The Bond Traders Associations recommend changes in trading regulations to the I.D.A.C. as market conditions dictate, and it is very rarely that these suggestions are not acted upon by the senior body.

21. As evidence of the integrity of the participants in the secondary market, it is interesting to note that transactions customarily are made verbally, with written confirmation being received the day following that on which the business was done. It is seldom that any misunderstanding has occurred, but when this has happened between dealers, the Bond Traders Associations and I.D.A.C. have been able to settle the matter quickly without reference to arbitration outside the Associations.

(c) Capital and Margin Requirements

22. The capital requirements for membership in the I.D.A.C. are stated in Appendix "A" of this I.D.A.C. brief. For those dealers who undertake liabilities of some consequence either for primary or secondary market operations, the need is substantial. A schedule of margin requirements, established to the satisfaction of the banking system, affords adequate protection to the lender for loans made to dealers against securities pledged. In addition to these minimum stipulations further specific liquid capital requirements must be maintained. This program is supervised by an established audit system and failure to comply is subject to certain penalties. Specific

details of capital and margin requirements are contained in the I.D.A.C. Blue Book, By-Law number 8A, Pages 334-338 and Regulations pursuant thereto Pages 405 to 412.

(d) Characteristics

23. The character of the secondary market is conditioned by the supply and types of securities which are available for trading. The table following indicates the supply of Canadian debt securities as at December 31, 1961 by par value and the approximate number of individual issues.

TABLE 5

	TOTAL DEBT (1) in millions of dollars	NO. OF ISSUES (2)
Canada Treasury Bills	1,885	26
Canadas & Guarantees (ex saving bonds)	12,663	41
Provincials & Guarantees	8,190	700±
Municipals	3,960	4000± (estimated)
Corporates	7,117	1000± (")
TOTALS	33,815	5767

Source: (1) Bank of Canada, Personal Communication, April, 1962.
(2) Various personal communications.

24. While there is a yield relationship which prevails throughout most categories of bonds, the trading characteristics vary from one class to another. The secondary market for Treasury Bills and Canadas under 3 years to maturity (the "Money Market") are covered in Appendix G of this I.D.A.C. brief and will not be discussed herein.

25. The volume of trading in Canadas and Guarantees maturing beyond 3 years is normally greater than in categories other than Money Market. In the earlier maturities of this group the market has reasonable depth and resilience but breadth is confined mainly to dealers, banks and other financial institutions. At present the longer end of the Canada market cannot be said to have normal depth, breadth or resilience. Such depth as does exist is provided mainly by the activities of the Securities Purchase Fund recently established by the Government. Reasons for this condition are dealt with in Section IV of this brief.

26. Provincial issues have good resilience and depth since uninhibited factors of supply and demand determine market levels. There is a steady flow of new issues coming to market and at the same time Sinking Fund operations combined with regular investment demand create a relatively stable balance. Certain issues, particularly those of Ontario and Quebec, can be said to have breadth due to a broad public interest within those Provinces but others appear to be restricted, in the main, to an institutional market.

27. Municipal bonds are primarily sold in the form of serial issues which tends to limit secondary trading. Resale can be arranged, usually on an order basis, through those dealers who participate actively in the municipal market. In the few instances where term bonds exist, a generally favourable market is available.

28. The market for Corporation bonds has breadth and resilience. However, after the first flush of activity which follows primary issues, supply usually becomes difficult to obtain. If, in due course, some doubt is cast upon the credit of any issuer, a supply then becomes available and investment buyers are difficult to find until the situation is clarified. Such cases frequently produce a speculative interest resulting in active trading. Corporate bonds with special features, such as convertibility, warrants, etc., usually have an active market depending on the performance of the associated equity.

29. It is interesting to note that in most circumstances the spread between bid and asked prices is relatively narrow. For example, in categories ranging from Government of Canadas maturing beyond 3 years through Provincials and Municipals to Corporates, the spread between the bid and asked prices customarily ranges from 1/8 of 1% to ½ of 1% in the more actively traded issues. This is brought about by keen competition among dealers and results in investors of all classes having access to fair prices. It is felt that the market as a whole has reasonable depth, but on some occasions investors wish to move actively in a similar direction, creating difficulty in maintaining a narrow price range. This is termed a "one-way market". In such instances, dealers who are prepared to take positions help to alleviate the situation until such time as investment buyers or sellers can be found.

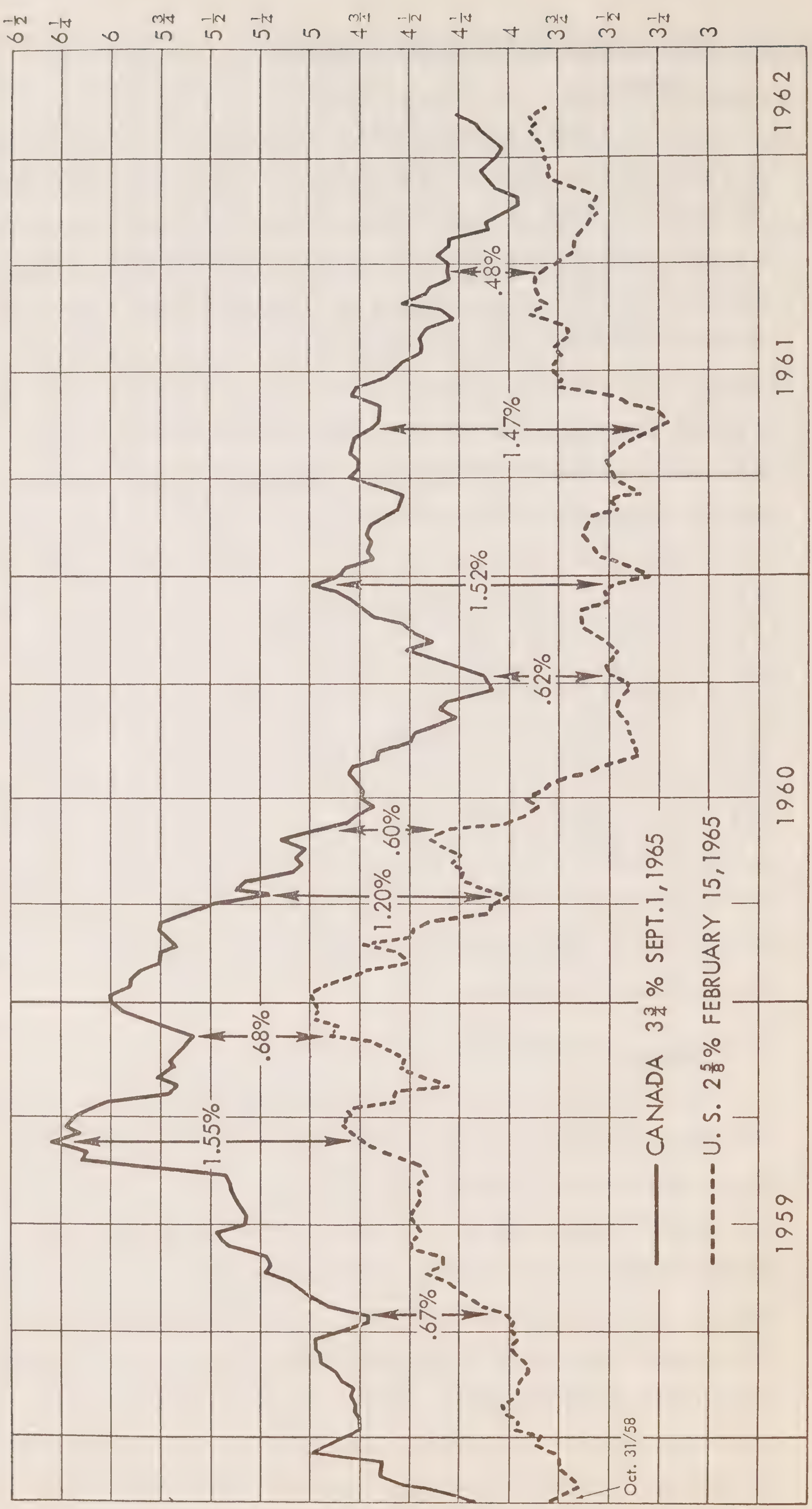
IV. SOME FACTORS AFFECTING SECONDARY MARKETS

External

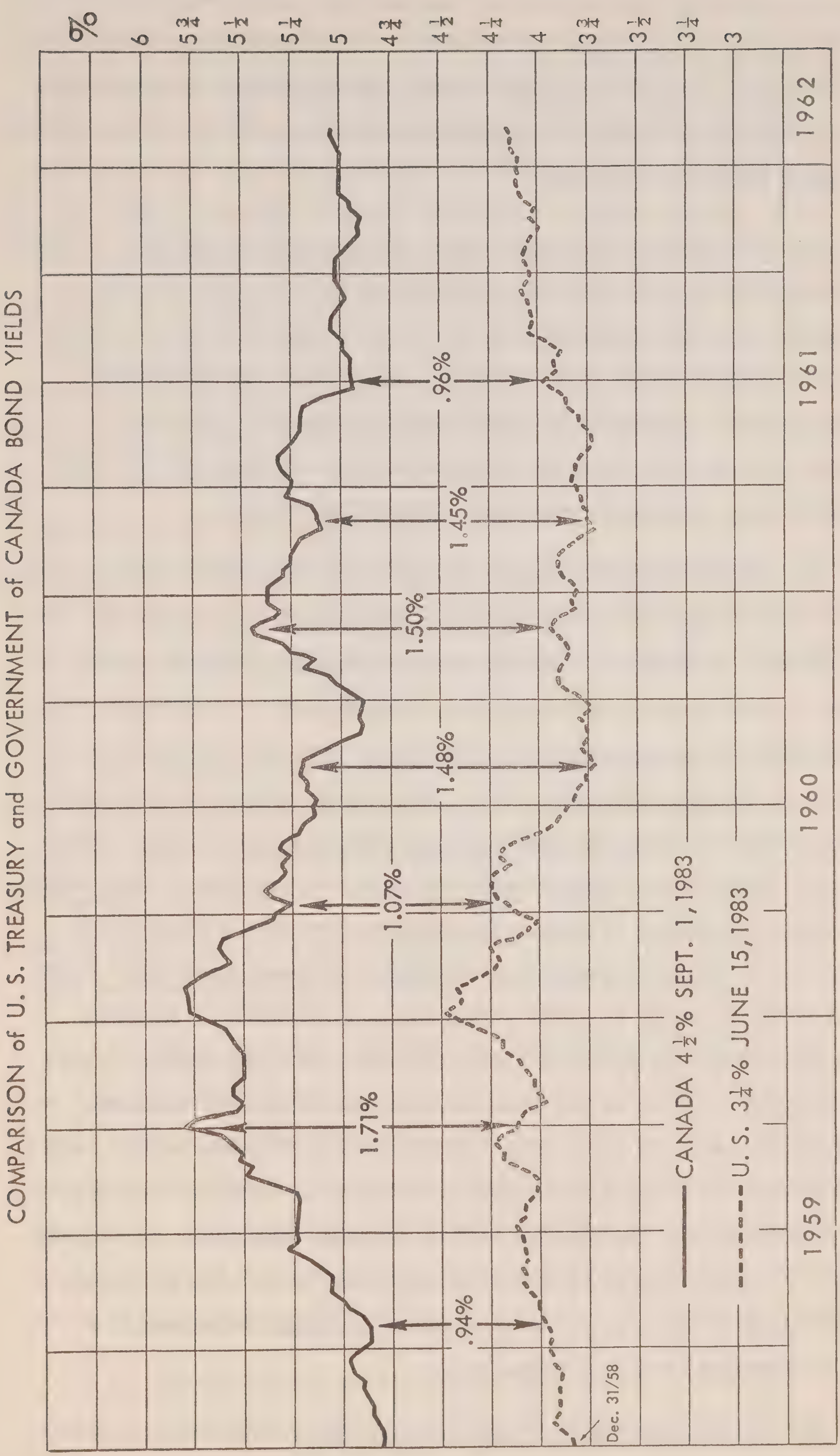
30. The relative levels at which bonds sell in the market are basically established by present, and estimates of future, supply of and demand for funds. As Canada is a developing country, there has almost always been a greater supply of bonds available than there have been funds seeking investment. If, during the early years of development, Great Britain, and in more recent times the United States, had not supplied large amounts of capital for the purchase of fixed-interest bearing securities, our economy could not have expanded to the degree which has been reached. Since we have had to depend on imports of capital to supplement what we were able to generate internally, our interest rate structure originally followed the levels established in Great Britain, but for many years now has been more closely aligned to that prevailing in the United States. It is only natural, therefore, that interest rates in Canada be higher than those prevailing in the United States if funds are to be attracted to this market from time to time. While the trend of interest rates in Canada usually adjusts to the general pattern in the United States, following a reasonable interval, it does not seem likely that any regular spread in rates between the two markets can be established. This thesis is borne out by reference to Charts I and II. Definition of a regular spread would seem to be precluded as policies peculiar to one or other of the two countries are varied, producing changes in the attitude of investors.

Internal

31. With the influence of the American interest rate structure in mind, there are many factors of a purely Canadian nature which constantly have a bearing on the level of prices in our bond market. Probably the single most important factor relating to interest rate trends in Canada is the Federal Government's fiscal policy. Closely associated with this is the direction of monetary policy, administered by Bank of Canada. Government fiscal policy is described in the annual budget address customarily presented to Parliament by the Minister of Finance sometime during the first six months of the calendar year. Occasionally there have been supplementary budgets and from time to time either in Parliament or during a public address the Minister of Finance has indicated certain policy changes. Because of the influence of Government policy, not only on the interest rate structure but



COMPARISON of U. S. TREASURY and GOVERNMENT of CANADA BOND YIELDS


COMPARISON of U. S. TREASURY and GOVERNMENT of CANADA BOND YIELDS
%
6
5¾
5½
5¼
5
4¾
4½
4¼
4
3¾
3½
3¼
3
.94%
1.71%
1.07%
1.48%
1.50%
1.45%
.96%
Dec. 31/58
CANADA 4½% SEPT. 1, 1983
U. S. 3¼% JUNE 15, 1983
1959
1960
1961
1962

in business planning in general, it is suggested that a great deal of uncertainty would be avoided if the budget address were to be delivered during the month of April each year. Also, for the same reasons, we suggest that an informative public address on the state of the nation be made annually by the Federal Government during the month of October.

32. The cornerstone of our interest rate structure is the rate on Federal Government obligations as these are considered almost risk free with regard to repayment of principal and interest due to the unlimited power of taxation and credit creation vested in the Government and Central Bank authorities. Interest rates for Government of Canada Bonds are, therefore, the prime rates on which rates for other bonds of similar maturities are based and from which the others vary according to the credit rating of the borrower.

33. During periods of economic recession and unemployment the practice of deficit financing for the purpose of revitalizing the economy has been generally accepted as a necessary social obligation. However, during the past 7 fiscal years ending March 31st, (1955-61 incl.) we have shown cash deficits in 6 years (with a small surplus in 1957) and the certainty of a deficit in the year ending March 31st, 1962. These deficits have occurred despite periods of prosperity which occurred during the years 1955-56, 1958-59 and 1961. These factors, together with the concurrent increase in money supply which has been necessary to finance the deficits, have done a great deal to destroy the confidence of investors in Government of Canada securities. Stability of price, which was the prime consideration in the minds of investors when they purchased Government of Canada securities, has been sharply reduced in this period. To take up the slack in Government financial requirements during recent years, the terms of the annual offering of Canada Savings Bonds have been expanded to the extent that a total amount in excess of 4 billion dollars is now held by the Canadian public. It would appear that the original intention of making this instrument available to the small saver and the payroll savings group has been discarded in favour of using the program as a means of obtaining funds on a volume basis.

34. The investor has also been encouraged by the 20% dividend tax credit to become more interested in equities which are regarded as some protection against inflationary tendencies. While this has been beneficial to

the financing of Canadian industry through equity issues, with an increasing volume of savings moving into the stock market, the private investor would seldom find himself in a position of wanting to purchase more than $10,000 of Government of Canada Bonds during the period of a year and this amount he has recently been able to obtain in the form of Canada Savings. These factors have tended substantially to reduce the number of private investors as buyers of Government bonds not carrying an early redemption privilege. Additional features concerning the Canada Savings program are discussed in Appendix B of this I.D.A.C. brief and mention is made of them here only to describe the influence which they have exerted on the breadth of the market for Government securities. The high level of taxation which has been reached, together with the erosion which has occurred in the purchasing power of our dollar, has tended to divert the interest of most investors away from Government of Canada securities and toward the higher yielding Provincial, Municipal and Corporation bonds. At the same time, the cost of capital to these more junior borrowers has been increased.

35. The institutional investor who, for one reason or another, must maintain a substantial portfolio of longer term bonds has reduced proportionately his holdings of Government of Canada Bonds and increased the other three categories. In other words, the professional investor regards those securities carrying additional yield as compensation for the loss of price stability which was formerly provided by Government of Canada securities.

36. Other investors such as the Chartered Banks, Trust Companies, and Corporations are, however, substantial buyers of short dated Government bonds. Only in this area, can volume be obtained to meet their requirements and, of course, prices are relatively stable due to the nearness of maturity. This section of the market has been greatly broadened and deepened due to the development of the money market which was undertaken in 1954. The particulars of this operation are discussed in Appendix G of this I.D.A.C. brief.

37. The Federal Government recently has followed a policy of obtaining its requirements, both for new cash and refundings, from the short to medium term areas of the market. This has helped to remove pressure from the long term market and has made possible financing by Provincial and

Municipal Governments as well as Corporate borrowers, many of whom would otherwise have been obliged to borrow in the United States market. In addition, the newly operating Securities Purchase Fund and the retirement and cancellation of bonds held by the Unemployment Insurance Fund, as announced in the Budget of June/61, have helped to reduce the supply of long term bonds for which there has been virtually no other demand and consequently have helped to maintain relatively stable market levels. While such programs are of importance in providing temporary support to bond markets, it would appear to be unrealistic to continue indefinitely a program of debt monetization. Rates of interest on Government of Canada bonds set the standard for most other classes of bonds. It is obvious that a method to restore confidence in Federal Government securities is of major importance if markets are to be stabilized over the long-term and the general functioning of the economy is to be improved.

38. There are many technical innovations which might be introduced in an effort to re-establish confidence in Government securities. However, it is felt that most technical suggestions would probably tend to veer away from orthodox financing practices and would result in only artificial stability. The problem should be approached through a program which will improve the intrinsic value of Government bonds. It would seem, therefore, that the major factors for consideration would be:

1. A determined effort to hold government spending within a balanced budget during other than recessionary periods and that when deficit spending appears to be necessary, sincere effort be made to direct funds toward the areas which are most likely to produce growth.

2. A re-examination of the tax structure and a revision to an equitable level to produce greater incentive and growth without reducing revenues.

39. If the basic problem of lack of confidence could be satisfactorily resolved, the functions of the secondary market would help to establish a stable interest rate structure which would greatly benefit the conduct of the economy.

40. Bank of Canada re-discount rate should revert to a stated rate which would permit the authorities to indicate clearly the intended direction of monetary policy (see also Appendix "C"). This in turn should permit greater flexibility by the Chartered Banks in their administration of prime and call loan rates. These rates appear to have been somewhat higher than necessary during several protracted periods, which may have been brought about in an effort to compensate for the unrealistic limitation of 6% during periods of monetary stringency. Call loans are supported by adequate collateral, providing prime credit for the Banks. Lack of flexibility by the Banks has driven borrowers to non-bank lenders thus narrowing the market by permitting potential investors to escape liability while employing their funds profitably. It is also suggested that non-bank lenders may not always be equipped to supervise these loans as effectively as the Chartered Banks. Nor does this procedure permit the monetary authorities and others to have proper knowledge of borrowing activity.

41. Income tax rates and the income against which the tax is assessed differ from one class of investor to another, as is indicated in Table 6.

TABLE 6 Approximate Tax Rates

Some Canadian Investors	Coupon %	Capital Appreciation %
Chartered Banks	50-53	50-53
Trust Companies, capital account	50-53	nil
guaranteed account	50-53	50-53
Insurance Co.'s - Life, mutual	nil	nil
Life, shareholder-owned	50-53*	nil
General	50-53	nil
Pension Funds	nil	nil
Mutual Funds - mutual	23	nil
- growth	50-53	nil
Estates and Trusts	14-80	nil
Charitable, Religious & Fraternal organizations	nil	nil
Individuals	0-80	nil
Non-financial Corporations	50-53	nil
Provincial & Municipal Governments	nil	nil

*on that part of income which is transferred to shareholders' equity. This amount is set actuarially.

These approximate tax rates may be modified by rulings of taxing authorities according to individual circumstances.

42. In order to maximize after-tax income, the requirements of one investor will vary from those of another in a different tax classification. For example, an individual in the higher tax brackets would be more interested in a low interest bearing security selling at a discount from par than in a high interest bearing security selling at par or at a premium over par, since he pays no income tax on capital appreciation. Conversely, pension funds, which are not taxable as to either income or appreciation, would be interested in the highest yield whether from a large coupon or from a substantial discount. As many investors are in a position to benefit greatly from non-taxable capital appreciation, bonds selling at a discount normally are in demand and trade on a lower yield basis than do higher coupon bonds. However, despite the lower gross yield such discount bonds usually provide a higher after-tax yield. Specific examples of the foregoing generalizations are shown in Table 7.

TABLE 7 Examples of Gross and After-Tax Yields

- tax rate taken as 50% on interest income.

Issuer	Coupon	Maturity	Price %	Gross Yield %	After-Tax Yield %
Prov. of Ont.	3%	Oct., 1977	80.25	4.80	3.10
Prov. of Ont.	6%	Nov., 1979	106.75	5.36	2.52
Canada	3¼%	June, 1976	83.25	4.89	3.08
Canada	5½%	Oct., 1975	103.25	5.17	2.47

43. Differences in the length of time to maturity play an important part in the requirements of various classifications of investors. Some, such as Banks, Trust Companies and most non-financial corporations, are generally interested in short term securities as a high degree of liquidity is required for most of their funds. Others are usually prepared to invest in mid to long term securities although for particular reasons, such as an anticipated decline in the market, they may invest some of their funds in short term securities.

44. Bond issues for which Sinking Funds or Purchase Funds have been established normally have a more favourable market than term bonds without these provisions. The annual requirements of such funds, affording underlying purchasing power in the market coupled with consequent debt reduction prior to maturity, creates broad investor confidence. Bonds issued with stipulated instalments maturing each year over the term of the obligation (serial bonds) are commonly sold to investors who do not contemplate re-sale. As a result, the secondary market for such bonds is not active although, through negotiation, other purchasers can usually be found. Bond issues which are sold by way of private placement to a limited number of financial institutions are not as a rule actively traded in the secondary market. As in the case of serial bonds, the investor purchases such issues with the intention of holding until redemption. However, new investors can usually be found should the original investor care to liquidate his holding.

45. Bonds carrying special provisions, such as convertibility into common stock, warrants to purchase stock and/or a bonus of common shares, trade in the secondary market at prices which bear greater relation to the performance of the underlying equity than to the normal interest rate structure. Convertible bonds, for the period of convertibility (which commonly is less than the full maturity of the bond), usually trade at a premium over the related value of the underlying equity. When the warrant or bonus features have been detached, or when convertibility has expired or lacks current value, the market for such bonds develops in line with the normal interest rate structure, having regard to the credit rating of the issuer.

V. RELATIONSHIP OF BANK OF CANADA TO SECONDARY MARKETS

46. Bank of Canada has Securities Representatives situated in its offices in Toronto and Montreal who maintain contact with the Investment Industry. Transactions may normally be arranged through them for the account of the Bank between the hours of 10:00 a.m. and 3:30 p.m. Transactions on behalf of others for whom they are acting may be arranged during the trading hours of 9:00 a.m. and 5:00 p.m. When the Bank has an interest in any specific issue either as principal or agent, its policy is to consider firm

offerings and firm bids. Infrequently an immediate reply may be forthcoming, but on most occasions approval must be obtained from the main office of the Bank in Ottawa. Delays of up to several hours are not uncommon causing considerable uncertainty to the market. As Bank of Canada is an important and generally active participant in the secondary market, it is recommended that a program of expediting reply be implemented.

47. Deleted.

48. Bank of Canada deals in securities to implement monetary policy, to adjust portfolio, to act on behalf of Purchase Fund and Government accounts, and more recently to redistribute certain new issues which it has accepted in whole or in part at time of issue. Consideration of methods used in distributing new issues is presented in Appendix "B" of this I.D.A.C. brief. However, the type of issue which is more or less continuously available to investors ("a tap issue") is harmful to the free operation of market forces as it effectively establishes a ceiling on prices or may well lead to overspeculation by dealers in their efforts to fully purchase, i.e. "clean up" the total issue. The market would function more effectively if substantial portions of all such issues were offered to the public at advertised prices and it is recommended that this policy be followed in future.

49. Deleted.

50. There is doubt that the Central Bank should act as agent for Government accounts and Purchase Fund as this seems to centralize a disproportionately large amount of the total funds which are actively in the market. Such accounts might be handled by the Department of Finance or by establishing separate trading functions for each account, thus reducing possible conflict with monetary policy.

51. It is recognized that many dealers and others have become accustomed to the present operations of the Bank and spend a great deal of time in trying to anticipate the Bank's policy. Inevitably some of such judgments prove to be incorrect and many have been prone to find fault with the Bank for not following the course which they had anticipated. If the above suggestions were implemented such people would be obliged to rely upon their own judgment and could not blame the monetary authorities for their own errors.

VI. MARKET DATA, AVAILABILITY AND ADEQUACY

52. In the normal course of events there is much statistical data which is regularly referred to in assessing market behaviour. For example, the weekly Financial Statistics provided by Bank of Canada enable those interested to keep abreast of many important factors. The Investment Dealers Association gathers and makes available to its members statistics relating to their overall non-bank loaning position. The Association also provides the press with a regular quotation service covering the more actively traded issues. Individual dealers supply the public with quotation sheets, money market statistics, general market comment, specific bids and offerings, and a flow of general information. The Dominion Bureau of Statistics supplies much useful statistical information. The Department of Trade and Commerce publishes reports on the Outlook for Private and Public Investment in Canada. In addition to these sources of information which are readily available, there are a number of statistical and/or forecasting services available in Canada whose information and projections are useful in predicting future yield trends.

53. Information relating to Central Bank action in the market and the reasoning behind such action would enable the market to function more smoothly. At present, the only detailed comment available on the Bank's actions and objectives is contained in its Annual Report. A regular report similar to the Monthly Review of the Federal Reserve Bank of New York or the Quarterly Review of the Bank of England would be helpful to market participants.

VII. CONSIDERATION OF A BOND EXCHANGE

54. From time to time, the question has arisen as to whether an organized Bond Exchange would provide better operating results than are

now available through the dealer secondary bond market. There are some aspects of an organized exchange which might be beneficial but it is submitted that the present system, which has evolved over the years, is best suited to meet the requirements of bond trading.

55. Some of the advantages of an exchange operation would appear to be the recording of volume and price changes and establishment of a focal point which might attract greater participation by the general public. However, bond quotations are readily available and volume figures would have little meaning since one major transaction would far outweigh, in its influence, any number of small transactions. The equity market is representative of almost every type of private industry and, while the market generally may be moving in one direction, special considerations may cause some stocks to move against the prevailing trend. This divergence of trends is not a factor in bond markets, since in most cases prices are based on yield. Individual price changes are, therefore, not significant since arbitrage quickly adjusts discrepancies.

56. The level of bond yields is largely developed by those professionals who manage substantial portfolios. The price at which the small investor may deal is, as a result, usually established by the major investor and provides the former with the safeguard of professional judgment. Furthermore, dealers who position bonds usually complete such transactions at net prices in line with institutional prices and consequently the private individual completes his business at a minimum of cost. If an organized bond exchange were established to replace the over-the-counter market, substantial costs for additional facilities would be required. The added cost of these facilities would have to be borne by the public in the form of established commissions. As an example, a dealer would regard a spread of $\frac{1}{2}$ of 1%, or $50 on a $10,000 corporation bond transaction in the secondary market, as reasonable compensation. Under stock exchange commission schedules, a $10,000 transaction in shares of the same company selling at $50 would cost the investor $80.

57. An exchange-type transaction requires the matching of offsetting orders with the broker acting as agent. However, due to the size of many bond transactions it would be unusual at any given time to find that matching orders existed. In recognition of this, dealers have organized themselves to assume liabilities, thus providing the service required without revealing the size and scope of orders. In the secondary bond market, the problem of investors moving in the same general direction frequently presents difficulties and these would be greatly aggravated by disclosure of transactions on an organized exchange market.

58. Bonds are traded on the New York Stock Exchange but only in relatively moderate volume. It is noteworthy that in the report of the Joint Congressional Committee's, "Study of the Dealer Market for Federal Government Securities" (Washington, 1960), it is stated that in 1958 only $1.4 billion in bonds were traded on the N.Y.S.E. vs. $176 billion of sales of Federal Government Securities alone through the dealer market. The latter figure does not include corporate, State and municipal bonds for which the volume of transactions through the over-the-counter market is not available. It is also notable that while bonds are traded through the London Stock Exchange, volume and prices of transactions are not published. Bonds, which formerly were traded on the Montreal Stock Exchange, have not been traded there for over 10 years and bond transactions on the Toronto Stock Exchange in 1961 aggregated only $14,435,000 of which $11,250,000 were Treasury Bills. For comparison, the approximate total volume of bond trading by members of the I.D.A.C. in the over-the-counter market in Canada during 1961 was in excess of 15¾ billion (Ref. Table 1).

59. It would seem, therefore, that the investing public in Canada can be best served at the lowest cost by the present system. A similar conclusion regarding the necessity of a dealer market for bonds has been reached in a study of the United States market.(1)

(1) Roosa, Robert V. - "Federal Reserve Operations in the Money and Government Securities Markets Federal Reserve Bank of New York 1956, Page 34.

VIII. RECOMMENDATIONS

Reference to Text

Paragraph Page

This brief has pointed out the importance of the secondary bond market to the capital market in particular and to the economy in general. While the secondary bond market functions reasonably well under present conditions, it is suggested that certain changes can, and should be made which would improve its utility in the continuing growth and development of the nation.

32 17 1.) Yields on Government of Canada securities are
the foundation of our interest rate structure. Recurring
33 17 deficits coupled with inflationary increases in the money
34 17 & 18 supply, and other factors, have severely damaged the
confidence of investors in Government securities and thus
35 18 threaten the whole market for fixed income bearing securi-
ties. To restore confidence in Government securities and
37 18 & 19 stabilize the interest rate structure it is strongly
recommended that:

38 19 a) a determined effort be made to balance the
Federal Budget during other than recessionary periods;

b) the nation's tax structure be examined and
38 19 revised in order to produce greater incentive and growth
throughout the economy.

2.) The information presently available to the
52 24 secondary market is, for the main part, adequate for in-
vestment decisions. However, there are areas in which ac-
31 14 & 17 tions and policy of the Federal Government are not clearly
stated. It is suggested that implementation of the following recommendations would materially aid dealers and investors in assessing Government influences on the secondary market and would assist in re-establishing confidence in Government securities.

Paragraph Page

31 14 & 17 a) Deliver the Federal Budget during the month of April each year.

31 14 & 17 b) Deliver an annual informative public address on the state of the nation during the month of October.

3.) Bank of Canada, as agent for Government accounts and as the administrator of monetary policy, is one of the most important factors in the secondary market. It is suggested that the following recommendations would improve the functioning of the secondary market and would assist the Government's and the Bank's direction of the economy.

a) Bank of Canada re-discount rate should revert
40 20 to a stated rate thus indicating the direction of monetary policy.

46 22 & 23 b) The Bank should implement a program designed to expedite reply to firm bids and offerings, thus removing one cause of uncertainty in the market.

48 23 c) "Tap issues", which are more or less continuously available to the market, are harmful to the free operation of market forces. Substantial portion of such issues should be offered to the public at advertised prices at the time of issue.

d) In order to decentralize some of the funds in the
50 23 market and to avoid possible conflicts with monetary policy, Government accounts and Purchase Fund should be handled by the Department of Finance or separate trading agencies.

e) A practice of issuing regular quarterly reports
53 24 by Bank of Canada, similar to the Monthly Review of the Federal Reserve Bank of New York or the Quarterly Review of the Bank of England, would aid the market's understanding of the Bank's actions and objectives.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX G

SHORT TERM MONEY MARKET

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX G

SHORT-TERM MONEY MARKET

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SHORT-TERM MONEY MARKET BRIEF

I. FORMATION AND GROWTH

(1) The money market in Canada had its earliest beginnings in 1934 when 91-day Treasury Bills were first sold by tender. The number of issues increased progressively and by 1937, tenders were held every other week and in 1953 a weekly tender was introduced. During this period, the Chartered Banks were the principal buyers and only occasional trades took place between the banks and the Bank of Canada. The banks did not trade with each other. Investment dealers performed a very limited role at this time, but they occasionally tendered for Treasury Bills on behalf of clients or purchased bills from the banks against orders. During the early nineteen fifties, certain dealers carried modest amounts of Treasury Bills in inventory and this increased as the Bank of Canada at the same time increased its market spreads and allowed the dealers further scope for their operations.

(2) Early in 1954, the Bank of Canada agreed to give certain dealers limits or lines of credit by which Treasury Bills could be discounted at the Bank under a sales repurchase agreement. This privilege was made available at a lower interest rate than that charged by the Chartered Banks under their call loans in order to encourage the dealers to trade in bills and carry an inventory. The market began to develop quickly from this point and the eligible paper was expanded to short-term Government of Canada bonds and guarantees maturing within three years. Thirteen dealers received lines of credit at the Bank of Canada and since that time the number has varied between twelve and the present fourteen. The names of the money market dealers, on March 31, 1962, are given in Exhibit "A".

(3) The next important step occurred in June 1954 when the first day-to-day loans were made by the Chartered Banks to the money market dealers. It was felt that if the money market dealers were to carry substantial inventories of bills and short governments, it was necessary that they should be able to finance these inventories at relatively attractive rates and low margin requirements to create reasonable incentives. The creation of the day loans provided the banks with a highly liquid earnings asset and allowed them to make the fullest possible use of other funds. The day loans were designed so that they could be called by either party prior to 12 o'clock on each business

day. During the first week, the day-loan rate was set at 1-1/2%, and thereafter the rate varied in response to monetary conditions. As a further aid, the banks agreed to communicate through an exchange broker the latest rates established on any transaction of one million or more. The Chartered Banks further co-operated by reducing their overcertification charge from 1/100 of 1% ($100 per million) to 1/250 of 1% ($40 per million).

(4) A significant change in the monetary system accompanied the formation of the short-term market. Through an amendment in the Bank Act, the banks were required to hold a cash reserve of 8%, whereas prior to this a 5% reserve had been mandatory, although in fact the banks had tended to hold a 10% reserve for liquidity purposes. Consequently the foregoing adjustment immediately made available approximately $200 million of investible funds. During this time, the Central Bank was carrying out an easy-money policy and, therefore, the money market in Canada developed quickly with the banks showing good demand for money market securities. The dealers built up an inventory and began to call active markets.

(5) In November and December 1955, the Bank of Canada "urged"(1) the Chartered Banks to adopt a policy of maintaining cash and secondary reserves equal to 15% of Canadian deposit liabilities. Secondary reserves at that time were defined as comprising of Treasury Bills and day-to-day loans. The banks were still required to maintain 8% of cash against deposit liabilities. The banks accepted the suggestion of the Bank of Canada and since May 31, 1956 have maintained secondary reserves above their required amount. This agreement, although somewhat restricting the Chartered Banks' operations, has allowed the banks to make minor adjustments to their cash position through the day-loan market without having to buy or sell Treasury Bills.

(6) In 1957, the banks eliminated the overcertification charges on money market transactions relating to the day-to-day banking of short-term securities. From that time on, it was possible for dealers to move their inventory from one bank to another, or to the Bank of Canada on a repurchase agreement, without being penalized with an overcertification charge. This was a further step to help the dealer broaden his inventory position.

(7) The Bank of Canada added another facility which greatly assisted the

Note: (1) Bank of Canada Annual Report 1955, page 16.

dealers in doing business outside of Toronto and Montreal. This was an arrangement whereby the Central Bank would release bonds at no cost to the dealer at any one of the Bank's nine agencies across the country; and after January 1957, any dealer could hand in bills or short bonds at any agency of the Bank of Canada, who would arrange to release the same securities the same day at any other agency of the Bank. Also during 1957, the use of Bank of Canada (same day) funds was eliminated, except in relation to withdrawals and deposits of currency and the making or repayment of advances. All other transactions were settled in clearing house (next day) funds.[2]

(8) Since 1954, the money market has expanded greatly and the term "money market" now embraces many transactions not related to Government of Canada short-term obligations. The money-market dealers have actively worked towards extending facilities of the market to meet the requirements of both borrowers and lenders. The various short-term obligations now in the money market will be discussed in detail in this report.

(9) At the outset of the money market, the dealer was a jobber owning an inventory of short-term securities for stock-in-trade to service both his clients and maintain an active trading market. Since dealer inventory nearly always exceeds the capital of the firm, it is necessary to borrow money to pay for the securities by assigning the securities to the lender as collateral for a loan. Initially most dealer loans were arranged with the Chartered Banks; however, some repurchases or buy-backs were arranged with investors as a convenient way of providing the exact maturity date in cases where Treasury Bills and other short-term obligations did not have a suitable maturity date. The security used in the repurchase agreement would normally be only slightly longer than the term of the repurchase so that the market liability of the dealer was kept to a minimum. The repurchase agreements were, in effect, equivalent to a security term loan and these transactions played a considerable part in introducing non-bank corporate and institutional investors to dealer loans. For short-term investors, these secured loans to the dealers became a convenient way of employing temporarily idle funds without taking any market risk. The range of collateral has broadened to include the obligations of provinces, municipalities and corporations. The dealer found that the ability to offer

Note: (2) Bank of Canada Annual Report.

buy-backs to accounts was often a valuable means of establishing business contacts and, as a result, inventory was often carried for the purpose of servicing these accounts. The role of the dealers, therefore, began to resemble more closely that of the London Discount Houses. The dealers took on the role of loaning money to both governments and corporations by owning their securities in inventory while borrowing funds from non-bank lenders to finance the inventory. This aspect of the money market was described in the Radcliffe Report.[1] "They earn their living mainly by borrowing money more cheaply than they lend it and, to some extent, from commissions and jobbing profits. They borrow for shorter periods than the periods of commitment in lending, (they 'lend short' but borrow even 'shorter')...."

(10) The dealer, by owning securities to give as collateral for repurchase loans as well as trading, provides an active market in short-term securities giving continuity and stability to the money market. The study of the dealer market for federal government securities, prepared by the Joint Economic Committee of the Congress of the United States,[2] states on page 94 that "the growth of repurchase agreements during the post-war years has played an important role in making the money market more efficient. Through repurchase agreements, the existence of higher interest rates is brought to the attention of small banks and non-financial corporations. Undoubtedly this has led to a more rapid adjustment by the private economy to the effects of changes in the supply of money and credit, and to a reduction of the time lag between introduction of a policy and the effectiveness of the policy." The dealer fulfills the role of a banker inasmuch as temporarily idle cash can be put to work for extremely short periods of time. The question of statistics and controls of dealer non-bank borrowing is discussed under the section on "Country Banks."

II. INSTRUMENTS IN THE MARKET

(a) Government of Canada Treasury Bills

(11) Treasury Bills are currently offered weekly by the Bank of Canada,

Note: (1) Committee on the Working of the Monetary System Report, page 58

(2) United States Government Printing Office, Washington, 1960

acting on behalf of the Government, through a competitive tender. There are no restrictions on who may tender, but the Chartered Banks, money-market dealers, and the Bank of Canada are the principal bidders. Sealed tenders are submitted to the Bank of Canada and are opened at 12 o' clock noon on Thursdays (except when holidays intervene). The Treasury Bills are awarded on the basis of price until the whole issue has been allotted. Frequently a bidder will submit half a dozen or more bids at different prices and only the highest of these will be accepted. Generally the total bids received from the banks and investment dealers, excluding the Bank of Canada, are for a greater amount of bills than those being offered so that all bids will not be successful. The Bank of Canada will also bid in competition with the others. It is the normal practice for the Bank of Canada to submit a reserve bid for the entire amount of each issue, in order to guard against a situation in which the tenders of other bidders might not be sufficient to subscribe for the entire issue.(1) At approximately 2:00 p.m. on the day of the tender, each participant receives a telephone call from the Bank of Canada giving the following information:

(i) number of bills won,

(ii) high, low and average tender for each maturity offered,

(iii) total amount and maturity of bills to be tendered for on the following week

(12) Since May 6, 1959, both 91-day and 182-day Treasury Bills have been offered. During the latter part of 1954 through November 1955, 273-day bills were offered. The following table shows the distribution of Treasury Bills as at December 31, 1961:

HOLDERS OF GOVERNMENT OF CANADA TREASURY BILLS (2)
(In $000,000)

As at December 31, 1961	Amount	%
Bank of Canada	298	(16)
Chartered Banks	1,172	(62)
Government Accounts	8	(--)
General Public	408	(22)
TOTAL	1,886	(100)

Note: (1) In England, "since the beginning of the Second World War, it has been agreed by the discount houses who are members of the London Discount Market Association that the total of their bids will always cover the tender." (Radcliffe Report, page 39) Commercial banks do not tender directly for Treasury Bills in England.

(2) Detailed statistics as to the holders of Government of Canada Treasury Bills since 1954 will be found in Exhibit "B".

(13) The statistics obtained by the Investment Dealers' Association indicate that members of the Association held an inventory of $171,864,000 in Treasury Bills at 1961 year end, or 9.1% of the Treasury Bills outstanding. As can be seen from the above table, the Chartered Banks are the principal owners of Treasury Bills and the main market for the dealer. The dealer, as mentioned earlier, will often carry Treasury Bills as inventory so that repurchase agreements can be entered into with particular accounts.

(14) The Chartered Banks tender for bills each week for their own account and provide the principal market for Treasury Bills in Canada. Inasmuch as they have to compete at the tender, they do not always obtain their full requirements and have to purchase bills in the market. Dealers from time to time enter into pre-tender contracts with the Chartered Banks, in which they agree to confirm to the bank a stated amount of bills at the average tender yield, less .02% in basis.

(15) At certain periods in the past when Canadian Treasury Bill yields were well above those prevailing in other countries and the cost of foreign exchange hedge was not prohibitive, bills were sold to non-residents. The introduction of the 15% withholding tax on Treasury Bills, instituted on March 16, 1961, reduced the sale to non-residents substantially. The withholding tax is calculated in such a manner as to prove more discriminating to non-residents than a 15% withholding tax would imply. (See Exhibit "C" regarding calculation of withholding tax on Treasury Bills.)

(b) Short-Term Government of Canada and Government of Canada Guaranteed Bonds

(16) Unfortunately the Bank of Canada statistics relating to the distribution of short-term bonds only include those having a maturity of two years and under. Therefore, complete statistical information relating to the accepted money market maturities of three years and under is not available. It will be a recommendation of this report that statistics regarding the outstanding amount and distribution of Government and Government guaranteed bonds, maturing within three years and under, be made available. The table below gives the distribution of Government securities maturing within two years as at December 31, 1961:

HOLDINGS OF GOVERNMENT OF CANADA BONDS (1)
(OF A MATURITY TWO YEARS AND UNDER)

As at December 31, 1961	Amount ($000,000)	%
Bank of Canada	514	(16)
Chartered Banks	1,089	(34)
Government Accounts (est.)	60	(2)
General Public	1,503	(48)
TOTAL	3,166	(100)

(17) The Investment Dealers' Association statistics indicate that dealers held $129,004,000 of short-term bonds, maturing within three years and under, in their inventory positions as of December 31, 1961. Information relating to holdings of the money-market dealers alone is not available.

(18) The long maturities issued by the Government (excluding C.N.R.) since the conversion loan of September 1, 1958 were all, with the exception of one issue, sold to the Bank of Canada for resale to the public. The long market has been relatively thin for government bonds, while the money market has grown rapidly so that funds appear to be available to satisfy most short-term borrowers at the present time. During the past few years, the Government has been particularly concerned about borrowing its cash requirements in the short-end of the market, as can be illustrated by the Minister of Finance's statement in the Budget of April 10, 1962:

"In my Budget speech last June, I said that in order to avoid congestion in the long market, we would for at least several months confine new federal issues to short-term bonds. During the past nine months, we have issued no long-term bonds; 375 million ranging in term from 5-1/4 to 6 years were placed directly with the Bank of Canada, and the terms of all other market issues in no case exceeded 3-1/2 years."

(19) One factor which should be mentioned regarding the question of financing the short-term debt of the federal government is that of competing for corporate surplus funds. Corporations, being subject to both federal and provincial taxes, are most attracted to securities offering the highest net or after-tax yield. Therefore, a low-coupon and high-discount bond, which will have

Note: (1) See Exhibit "D" for holders of Government of Canada bonds maturing two years and under, from 1954 to 1961.

a certain portion of tax-free capital appreciation, is relatively attractive. There has been a strong incentive by borrowers to issue low-coupon, deep-discount securities in the past. However, the Budget of December 20, 1960, imposed the following restrictions:

"that where the contractual rate of interest on any bond, debenture, or similar evidence of indebtedness, issued by a tax-exempt borrower, is less than 5%, and where the bond or debenture is issued at a discount which provides an effective yield to maturity or to the earliest call date that exceeds the contractual rate by more than one-third, the whole discount shall be deemed to be income in the hand of the first Canadian resident taxable holder of the instrument." (See Page 1011 Hansard, December 20, 1960.) Prior to this legislation, coupons of as low as 1-1/2% were used by all levels of Government and corporations alike in raising funds in the short-term market.

(20) An exception to this practice of raising money on low-coupon notes was the introduction, in the issue of October 1, 1959, or $250 million Government of Canada 5-1/2%, October 1, 1962, convertible at the holder's option at any time prior to June 30, 1962, into 5-1/2's October 1, 1975. This issue attracted considerable attention from both corporate and institutional investors. Since that time, an additional $100 million, 5-1/2% of October 1, 1962, were offered and $448 million 5-1/2's, April 1, 1963, convertible into 5-1/2's, due April 1, 1976.

(21) There are no restrictions on the investment dealers that can trade in the market in either Treasury Bills or short Government bonds. The various bond traders associations have established regulations relating to trading, which set the minimum size of trading at $100,000, in order to provide a flexible and responsive market. The trading rules relating to the money market sector, laid down by the Toronto Bond Dealers' Association, are given in Exhibit "E".

(c) Bankers Acceptances

(22) Preliminary work has been done by both the Chartered Banks and money-market dealers, in conjunction with the Bank of Canada, in examining the possibility of an Acceptance market in Canada. The banks must initiate this new development by being prepared to "accept" corporate paper for a set fee. It is expected that the money-market dealers would be able to bank such paper in the

day-loan market provided by the Chartered Banks and that it would, at some point, be eligible for rediscounting at the Bank of Canada. The dealer would be a jobber on such Acceptances and it is thought that the banks would be the principal buyers of the paper. Acceptances, as they are presently visualized, would provide the investor with a rate of return somewhat between Treasury Bills and prime finance paper. At the present time, certain questions of taxation have held up the introduction of Acceptances.

(d). Provincial and Municipal.

(23) i) Provincial - The provinces have been attracted to the short-term market to meet some of their requirements for funds. Although they have been traditionally borrowers in the long-term market, they have found that the developing short term money market can provide them with a flexible source of funds to help meet their total requirements. The money market has provided them with a means of selling provincial Treasury Bills (Manitoba and Saskatchewan), short-term low-coupon bonds for periods of usually two years or less, and parity bonds. Parity bonds compete for short-term funds when the rates are attractive and when no restrictions are placed on the amount sold to any one purchaser.

(24) D.B.S. statistics provide some information with regard to provincial short-term debt outstanding and issued during the fiscal year, but this does not include securities issued by authorities and guaranteed by the provinces. Both British Columbia and Alberta have been very active in financing some of their requirements through provincial-guaranteed short-term securities.

(25) The dealer syndicates formed to underwrite the long-term borrowing needs of the provinces usually do not prohibit the dealer from negotiating directly with the provinces for securities of two years and under. Therefore, a considerable amount of short-term financing by the provinces has been arranged privately and little information is available. However, some provinces, notably Alberta and British Columbia, have called for tenders on particular blocks of short-term maturities and dealers, in this case, will either tender alone or form a group to tender on a particular offering.

(26) The majority of provincial short-term bonds are offered as low-coupon as possible, under the restrictions described on page 8, paragraph 19.

Short-term provincial bonds do not trade actively. Therefore, the owner of such investments, having to value them on a regular basis, will usually receive a theoretical valuation which is not subject to swings in the market.

(27) ii) Municipal - A number of municipalities, including such names as Metro Toronto, cities of Toronto, Montreal, Hamilton, Winnipeg, Vancouver, London, Kitchener and Kingston, have already taken advantage of the short-term money market. Most municipal borrowings are designed to meet current expenditures prior to tax receipts being received, and often allows them to choose the most favourable time for financing in the long market.

(28) The larger municipalities call for tenders on their short-term obligations; however, some are arranged on a negotiated basis. Inasmuch as most municipal short-term borrowings are relatively small, dealers act independently and are not normally restricted by syndicates when tendering for short-term offerings.

(29) Little information is available to indicate the amount of municipal short-term debt arranged during the past few years. However, it would appear that during the first quarter of 1962 in excess of $35,000,000 was borrowed by municipalities in the short term market.

(e) Finance Company Paper

Sales finance companies raise a substantial percentage of their borrowing requirements in the money market. Prime finance companies, including such names as General Motors Acceptance Corporation, Industrial Acceptance Corporation, Limited, Traders Finance Corporation, etc., borrow for terms of one year or less at somewhat similar rates. These rates are sensitive to the supply and demand of short-term money and are usually accurate indications as to the availability of such funds. Second-line finance companies will pay rates often up to 1/2 of 1% more in order to meet their borrowing requirements.

(31) The amount of finance paper outstanding at the present time might be estimated to be in excess of $500 million.(1)

NOTE: (1) The Federal Council of Sales Finance Companies estimate that the ten largest finance companies had short-term obligations during 1961 of between $410 million and $525 million.

(32) Dealers act as agents on behalf of the finance companies and receive a commission for locating purchasers of this paper. At certain times, dealers will inventory this paper, but by doing so must find suitable "country bank" accommodation to carry it. I.D.A. statistics indicate that dealers were carrying inventory of $31 million in finance company and corporate paper on December 31, 1961.

(f) Corporate Paper

(33) This sector of the money market has attracted considerable attention inasmuch as it has grown very rapidly and is a development that was not visualized in 1954. Corporate paper has shown this growth for several reasons. The cost of corporate borrowing from the Chartered Banks has been relatively high compared with the availability of short-term money, and the corporate paper, itself, has found a ready market with short-term investors. This is largely true because corporations do not establish fixed rates at which they will sell their paper and each is perfectly free to choose whatever term or rate they think is necessary to attract money. Therefore, the senior credits can compete actively with finance companies through small variations in rates paid. Corporate paper is also issued on a "demand" basis by which the investor purchases a liquid investment at a fixed rate of return. This paper can be called on 24-hours notice by the purchaser, or in some cases by both parties, and has become very attractive to investors at times when the immediate outlook for short-term rates is uncertain. The corporation borrowing through "demand" paper also receives the advantage of obtaining funds at the lowest possible rate. The return on "demand" paper is closely related to the day-to-day money rate and the 30-day prime finance paper rate.

(34) Corporate borrowers in the money market include retail stores, oil companies, grain merchants, chemical manufacturers, breweries, distillers, and many others. These companies have been attracted to the money market primarily due to the relatively high cost of borrowing at the Chartered Banks at the prime rate. Exhibit "F" illustrates the spread between the prime rate and the cost of 30-day money for a senior corporation paper since 1959.

(35) It is expected that companies using the money market for a certain part of their borrowing requirements will have bank lines of credit available to cover any amount of paper outstanding and, in most cases, companies continue to borrow a certain amount from their banks.

(36) Like many segments of the money market, there is little or no statistical information available. A survey of the larger borrowers as to their authorization to borrow in the short-term market indicates that, at any one time, there could be up to $450 million corporate paper in the market. However, it is more likely that the actual borrowings by corporations would range between $275 million and $325 million at present.

(37) As the money market grows, there are an increasing number of corporations of many kinds borrowing in the short-term market, and it becomes more difficult for the purchaser of the paper to be selective and have time to examine the credit standing of each name. It is important that, if the paper market is to grow in a responsible manner, the buyers be fully aware of the credits they are purchasing. This is especially true as a large volume of paper is sold on a "demand" basis and perhaps not enough attention is paid to the name of the borrower.

(38) The dealer normally acts as an agent in selling corporate paper and receives a smaller commission than that paid by finance companies. Although the commissions are small, the dealer often feels that establishing contact with the corporation to offer short-term paper can, in the long run, be most rewarding.

(g) Deposits

(39) i) Chartered Banks - The banks recently established set rates at which they will accept deposits for terms of up to one year. These rates have tended to be 1/4 of 1% below those offered by the prime finance companies but, on some occasions, the rates have competed with finance company paper. These deposits are often particularly attractive to those restricted to trustee investments. One bank issues deposit certificates for terms of one to six years at a published rate. These certificates can be transferred and have some measure of liquidity. The bank pays dealers a commission for placing these medium term certificates.

(40) The banks will also accept deposits in U.S. dollars at their American agencies. The Canadian banks compete among themselves for U.S. dollar deposits and do not keep to any uniform rate schedule. The banks are not restricted by regulations of the Federal Reserve Board as to the rate that may be paid on deposits of one year and under in the United States and, as a result, the Canadian banks have attracted a large number of deposits from both American institutions and corporations. The banks will also compete, between themselves, for U.S. dollar deposits from Canadians by offering a Canadian account a U.S. dollar deposit fully hedged. In this way, a Canadian account can purchase U.S. dollars and leave them on deposit with a Canadian bank in New York and sell the U.S. dollars forward at maturity of the deposit, often obtaining a return in excess of that paid by the finance companies in Canada. U.S. dollar deposits with the Canadian banks in New York are not subject to withholding tax.

ii) Trust Companies

(41) Trust companies issue deposit receipts which are non-transferable. Some provincial accounts, municipalities and corporations, restricted to trustee investments place their short-term funds with the trust companies on deposit.

(42) The dealers play a considerable role in helping the trust companies obtain deposits, and in some cases the trust companies will pay a commission for deposits obtained at a specified rate. However, it is more usual for the trust company to accept a deposit if a suitable offset investment can be arranged. This involves the dealer originally locating the client, agreeing on a rate at which the trust company deposit would be attractive, then offering the trust company an offset investment (finance or corporate paper, etc.) at 1/4 to 1/2 of 1% higher than the deposit rate. Some trust companies pool all their short-term investments in a central fund and accept deposits at rates based on their over-all short-term earnings. Since the banks have become more aggressive in seeking deposits, the trust companies too have had to become more competitive, and it appears that they are becoming more active in soliciting deposits rather than just accepting them.

(h) Export Finance Corporation of Canada Limited

(43) Another recent issuer of short-term paper is the Export Finance Corporation of Canada Limited, which is wholly owned by Canada's eight Chartered Banks. This corporation borrows money in the short-term market in order to assist mid-term (one to five years) financing for exports which have been insured by the Export Credits Insurance Corporation, a Crown company. Most of the notes which have been sold by the Export Finance Corporation of Canada Limited have been payable in U.S. dollars for periods up to 180 days, and have been bought by the Chartered Banks directly from the Corporation. However, dealers have placed $16 million with clients other than the Chartered Banks as of March 31, 1962. Short-term U.S. pay paper of Export Finance Corporation is subject to a 15% withholding tax.

III. PARTICIPANTS

(a) Bank of Canada

(44) i) Dealer Lines of Credit - Money-market dealers, as mentioned earlier, have lines of credit with the Central Bank which allow them to enter into repurchase agreements with the Bank to finance their inventory of Treasury Bills and Government of Canada money-market securities when other sources of accommodation are not available. Thus, the Bank of Canada is the "lender of last resort" for the dealer. These lines are confirmed monthly and are open to some negotiation. However, extensions to the existing lines are usually granted for short periods when requested. It is important for the development of the money market that these lines be as flexible as possible if the money market is to grow and adapt itself to changing circumstances. The lines of credit, however, must be related to the financial responsibility of the money-market firm.

(45) ii) Bank Rate - There has been much criticism directed at the variable Bank Rate since its introduction on November 1, 1956. Elsewhere in the I.D.A. brief, there is an expression of opinion that a floating Bank Rate, calculated weekly at a rate of 1/4 of 1% above the average price tendered for 91-day Treasury Bills, gives little guidance to the market as to the Bank of Canada and Government policy. However, it is the feeling of this committee that the variable Bank Rate is an important development in adapting the Canadian money market to our particular monetary system.

(46) Dealer inventories of money-market securities are normally financed through day-to-day loans at the Chartered Banks, and these day loans form the banks' most liquid asset next to cash. Therefore, when the Central Bank adjusts the cash in the banking system or a dislocation of cash between the eight banks takes place, the availability of day loans can vary greatly. Money-market dealers have been able to use their lines of credit at the Central Bank during these periods of cash adjustment when day-to-day money is not sufficient to look after their commitments in the normal course of business. Dealers, knowing that the Central Bank's reserves are available at a small penalty rate, are, therefore, more active participants in the money market. In this way, they can operate with confidence knowing their position is always protected, although they may have to pay the current Bank Rate as established each week by the Bank of Canada.

(47) However, should the Bank of Canada return to a traditional Bank Rate, then, because of the dependency of the money-market dealers upon the "lender of last resort" periodically, there should be an additional flexible rate similar to the floating Bank Rate so that money-market dealers could continue to operate and be protected by their lines of credit at a borrowing rate which is related to the current yields on Treasury Bills. This rate might be renamed "Bank Lending Rate" or "Bank Accommodation Rate."

(48) Dealers rediscounted securities, under the purchase and resale agreement with the Bank of Canada during 12 weeks of 1959, 17 weeks in 1960, and 11 weeks in 1961, according to the weekly statistics provided by the Bank of Canada.

iii) Market

(49) The prime function of a mature money market is to equate supply and demand of short-term capital; the speed and flexibility of the market is of the utmost importance. The dealers or "jobbers" provide a market which is very sensitive as to price and they transfer large amounts of securities with little market dislocation. The problem of having two financial centres in both Toronto and Montreal has been effectively eliminated. However, the Bank of Canada's trading departments in Toronto and Montreal, which are the Bank of Canada's contacts with the market, lack sufficient equipment and staff to handle the practical problems relating to the money market.

The dealer at present finds it difficult to contact the Bank of Canada quickly and receive immediate answers.

(50) The main criticisms concerning the trading operations of the Bank are:-

(a) Decisions concerning most transactions are made in Ottawa and the Bank trader is usually given little or no discretionary powers.

(b) The Bank traders do not have direct "key" telephone lines to money-market dealers and Chartered Banks

(c) One trader handles all sections of the Government market and does not have time to be fully acquainted with the factors influencing the money market.

(51) (iv) Statistical Information - The Bank of Canada publishes an excellent weekly and monthly series of statistics, as well as an annual summary, covering the Bank's, Federal Government's and Chartered Banks' operations. These figures are of particular interest to the money market because of information relating to the cash position of the banking system as a whole and weekly changes in holdings of Government securities, as well as weekly changes in Chartered Bank loans (day-to-day loans, call loans, general loans, etc.). However, statistics relating to the holding of Government money-market securities, three years and under, are not available, inasmuch as the official breakdown of holdings of Government bonds is into categories of two years and under and two years to five years. It is suggested that the published statistics should agree with the "market" definition of short-term maturities, i.e., three years and under.

(52) At the present time, there is very little information collected and published by the Bank of Canada or D.B.S. relating to the new short-term issues of provincial and municipal authorities, finance companies and corporations. Inasmuch as this sector of the money market is expanding rapidly, there should be a better understanding of the role of each borrower.

(53 v) Loan of Securities - The Bank of Canada at one time was prepared to enter into a "reversible switch" arrangement for 30 days against suitable collateral. However, the rates charged appeared to be more than the market would bear and little use was made of this facility.

IV "Country Banks"

(54) The reasons for the development of "country banking" is given in Section I. of this report. As mentioned previously, the dealer in holding inventory to "bank" out for short periods of time, is following in the tradition of the twelve London discount houses and the seven American Government Bond dealers. (See Page 4, paragraphs 9 and 10.)

(55) The Investment Dealers Association, being fully aware of the increasing use of non-bank borrowing by the dealers, began last year to collect weekly statistics relating to the current volume of securities being financed through the "country banks". Each dealer reports directly to the I.D.A. auditors once a week the amount of Treasury Bills, money-market bonds, Government of Canada's three years and under, and other bonds banked away from the Chartered Banks. The combined totals of these figures are made available to members of the I.D.A., the Department of Finance, and the Bank of Canada. On December 27, 1961, dealers were banking out the following securities:-

Securities Banked by Members of the I.D.A. with the "Country Banks"

	($000,000)
Treasury Bills	72.4
Money Market	17.1
Canada's (three years and over)	9.7
Other Securities (not including stocks)	69.1
TOTAL	168.3

(56) In 1961, there were 11 weeks during which dealers banked over $100 million in Treasury Bills away from the banking system. Therefore, it can be seen that the "country banks" helped finance a considerable portion of the dealer inventory.

V. NON-RESIDENT SHORT-TERM INVESTMENTS IN CANADIAN SHORT-TERM SECURITIES

(57) Non-residents have been active purchasers of Canadian short-term obligations over the past few years. Inasmuch as the Canadian dollar is not "pegged" and liable to wide swings, non-residents have been fully hedging their investments to eliminate any foreign exchange risk. It is usually possible to obtain forward exchange contracts for periods of up to one year. The fully hedged rate (the non-resident purchases Canadian dollars spot and sells forward at the maturity date of his investment) is dependent upon the cost or profit of hedging funds as well as the gross yield on the short-term obligation purchased.

(58) Prior to the introduction of the 15% withholding tax on Treasury Bills, a considerable amount of Treasury Bills was sold abroad. Since that time, however, finance company and corporate paper has replaced Treasury Bills. This paper is also subject to a 15% withholding tax deducted at maturity, but this tax is calculated and deducted easier than on Treasury Bills. In some cases, this resulted in the non-resident investor being introduced to alternative short-term investments in Canada that offered higher yields than those available on Treasury Bills. It should be remembered that short-term Government of Canada bonds, issued prior to December 20, 1960, are free of withholding tax to non-resident purchases.

(59) Short-term foreign flows of funds into Canada's money market on a fully hedged basis would appear to have little influence on the factors affecting non-resident control of Canadian resources and manufacturing and, therefore, should not be subject to strong discrimination. However, the amount of non-resident ownership of money-market securities should be known in case restrictions are placed by foreign governments on their subjects investing funds outside their borders. At present, it is doubtful if any accurate figure of Canadian short-term paper owned by non-residents is known but an estimate of 300 - 350 million dollars might be made. This figure would include Treasury Bills, Government of Canada bonds, finance and corporate paper.

(60) Canadian banks from time to time actively solicit U.S. dollar deposits as described in the section on bank deposits. The rate of return accruing to the investor on these deposits is not subject to withholding tax.

(61) Canadian short-term investors will also place funds outside the country when foreign rates are attractive. Most investments of this sort are also made on a fully hedged basis. From time to time, the hedged rate of return on U.S. Treasury Bills or short-term paper becomes attractive largely due to the profit that can be made on hedging the investment.

RECOMMENDATIONS

	References	
1) The money market performs an important function in contributing to Canada's economic development by helping to fully utilize all available sources of capital. It is, therefore, recommended that the money market should continue to receive the excellent support that it has obtained in the past from both the Bank of Canada and the Chartered Banks.	See Growth of Money Market.	
	Page No.	Paragraph No.
2) The difficulty of obtaining accurate statistics for the preparation of a study on the money market illustrates the difficulty in assessing the roles of the various borrowers in the money market. It is recommended that more information be obtained and published concerning the borrowing by provinces, municipalities and corporations in the money market.	6 9 10 12 16	16 24 29 36 49
3) Short-term foreign flows of funds into Canada's money market on a fully hedged basis would appear to have little influence on the factors affecting non-resident control of Canadian resources and manufacturing and, therefore, should not be discriminated against. The question of withholding tax on all short-term investments should be closely examined.	18	57
4) It is a recommendation that closer liaison be established between the Bank of Canada and the money-market dealers for the purpose of trading in money-market securities.	15 16	49 50

EXHIBIT "A"

MONEY MARKET DEALERS RECEIVING LINES OF CREDIT
AT THE BANK OF CANADA,
AS AT MARCH 31, 1962

Ames, A.E., & Co. Limited

Burns Bros. & Denton Limited

Dominion Securities Corp. Limited

Equitable Securities Canada Limited

Gairdner & Company Limited

Greenshields & Company Inc.

Harris & Partners Limited

McLeod, Young, Weir & Co. Limited

Midland Securities Corp. Limited

Mills, Spence & Company Limited

Nesbitt, Thomson & Company Limited

Richardson, James, & Sons

Royal Securities Corp. Limited

Wood, Gundy & Company Limited

EXHIBIT "B"

HOLDERS OF GOVERNMENT OF CANADA TREASURY BILLS.

(In $000,000)

As at December 31st	1954	(%)	1955	(%)	1956	(%)	1957	(%)	1958	(%)	1959	(%)	1960	(%)	1961	(%)
Bank of Canada	169	(22)	264	(22)	507	(32)	469	(29)	36	(2)	309	(15)	407	(20)	298	(16)
Chartered Banks	363	(46)	430	(35)	743	(47)	808	(50)	956	(64)	983	(48)	974	(49)	1172	(62)
Gov. Accounts	41	(5)	36	(3)	40	(3)	59	(4)	89	(6)	30	(1)	56	(2)	8	(--)
General Public	208	(27)	494	(40)	285	(18)	289	(17)	415	(28)	755	(36)	549	(29)	408	(22)
TOTAL	781	(100)	1,224	(100)	1,575	(100)	1,625	(100)	1,496	(100)	2,077	(100)	1,986	(100)	1,886	(100)

EXHIBIT "C"

WITHHOLDING TAX ON TREASURY BILLS

An extract from House of Commons Debates, Vol. 105, No. 69, Official Report for Thursday, March 16th, 1961, Page 3060, referring to an amendment to Section 108 of Bill C-73.

"This amendment provides that when a resident of Canada sells a Treasury Bill to a non-resident, the non-resident shall be deemed to have received a payment of interest. The amount of interest he shall be deemed to have received shall be equal to the proportion of the difference between the original issue price and the face value of the bill, that is, the proportion of the original discount, which is attributable to the unexpired portion of the term of the bill remaining at the time it is purchased by the non-resident.

"Since this amendment deems interest to have been paid to the non-resident at the time the non-resident purchased a Treasury Bill, the Canadian resident who sells the Treasury Bill will be obliged to withhold the 15 per cent non-resident withholding tax on the amount that is deemed to be interest.

"If, at some subsequent time before maturity, the non-resident sells the Treasury Bill back to a Canadian resident, the non-resident will be eligible for a refund of that part of the tax he has paid which is attributable to the unexpired portion of the term of the bill."

EXHIBIT "D"

HOLDINGS OF GOVERNMENT OF CANADA BONDS

(OF A MATURITY TWO YEARS AND UNDER)

(In $000,000)

As at December 31st	1954	1955	1956	(%)	1957	(%)	1958	(%)	1959	(%)	1960	(%)	1961	(%)
Bank of Canada	1,193	1,021	520*	(24)	779	(31)	245	(11)	514	(18)	353	(16)	514	(16)
Chartered Banks	636	475	405	(19)	410*	(16)	826	(36)	657	(23)	615	(28)	1,089	(34)
Gov. Accounts (est.)	N.A.	N.A.	165	(7)	126	(5)	243	(10)	86	(3)	111	(5)	60	(2)
General Public	481	677	1,079	(50)	1,223	(48)	1,010	(43)	1,610	(56)	1,147	(51)	1,503	(48)
TOTAL	N.A.	N.A.	2,170	(100)	2,538	(100)	2,324	(100)	2,867	(100)	2,226	(100)	3,166	(100)

*Owing to changes in valuation procedures, these figures are not comparable with those of the foregoing year.

EXHIBIT "E"

TRADING REGULATIONS -- JANUARY 1, 1961

All transactions by dealers, whether acting in the capacity of either principal or agent, shall be as follows:-

....

2) There are no spread restrictions regarding trading of Government of Canada Bonds and Government of Canada Guaranteed Bonds having an unexpired term of one year or less to maturity, (or to the earliest call date where a transaction is completed at a premium).

3) All Government of Canada Bonds and Government of Canada Guaranteed Bonds having an unexpired term of over one year but three years or less to maturity (or to the earliest call date where a transaction is completed at a premium) shall be traded in multiples of five cents.

5) (a) Unless prefixed by some qualifying phrase, a dealer calling a market shall be obliged to trade Trading Units (as hereinafter defined), if called upon to trade;

(b) Any dealer asking the size of a stated market must be prepared to buy or sell at least a Trading Unit (as hereinafter defined) at the price quoted if immediately requested to do so by the member calling the market;

(c) Trading Units shall consist of the following:

(i) In the case of Government of Canada direct obligations and Government of Canada Guaranteed obligations having an unexpired term of three years or less to maturity (or to the earliest call date, where the transaction is completed at a premium); $100,000 -- par value.

(ii) In the case of Government of Canada direct obligations and Government of Canada Guaranteed obligations, having an unexpired term to maturity of longer than three years (where a bond is traded at a premium the earliest call date shall be treated as the maturity date); $25,000 -- par value.

continued ....

EXHIBIT "E" (continued)

(iii) In the case of all other bonds and debentures other than Government of Canada direct obligations and Government of Canada Guaranteed obligations; $5,000 -- par value.

(iv) In the case of bonds and debentures issued with attached stock, warrants rights, or other appendages and traded in unit form; $5,000 par value of Bonds or Debentures, irrespective of the value of the appendages.

(v) In the case of common and preferred shares not listed on a recognized stock exchange (as defined in the Regulations of the I.D.A.)

-- in lots of 500 shares, if market price is below $1

-- in lots of 100 shares, if market price is at $1 and below $100

-- in lots of 50 shares, if market price is at $100 or above.

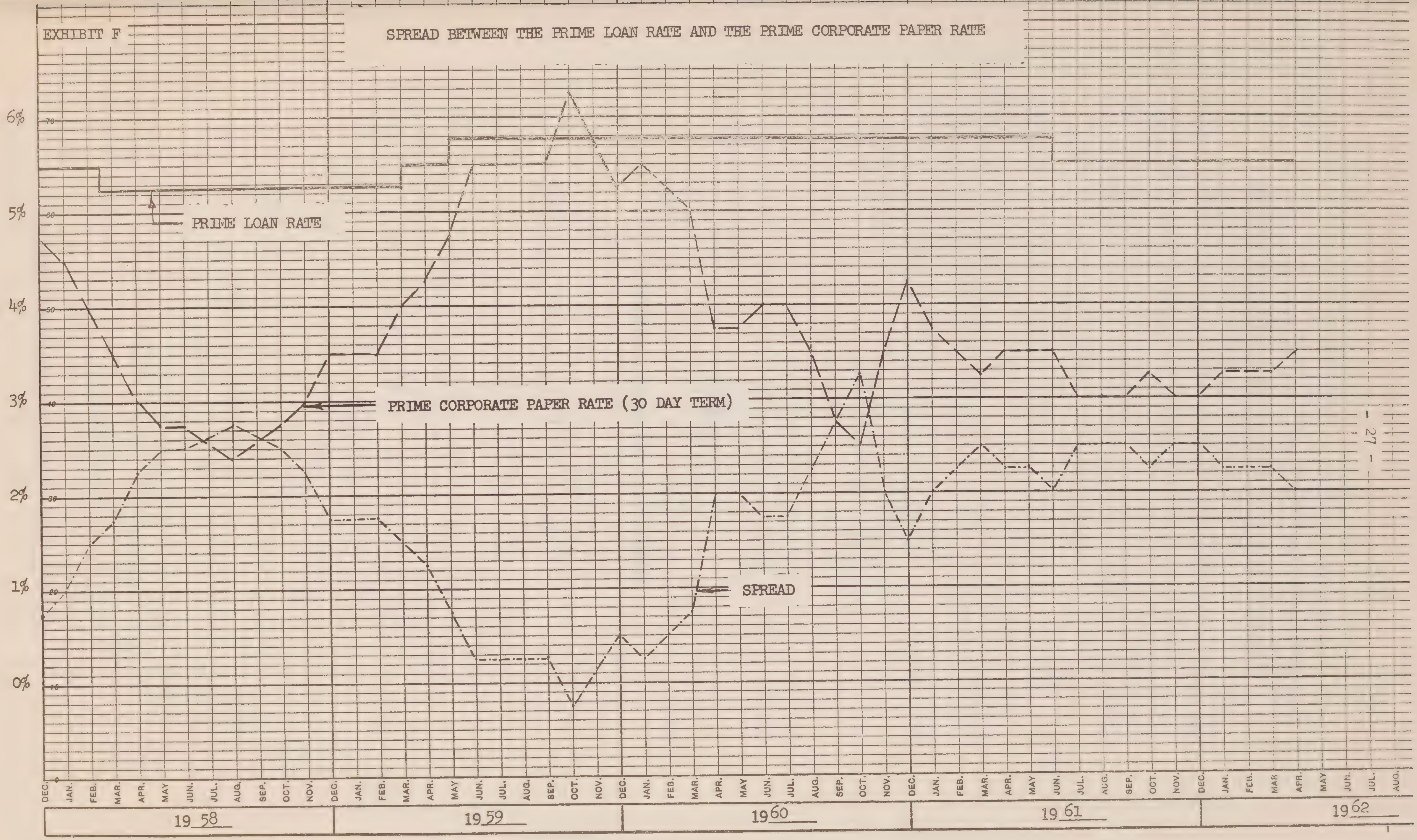
EXHIBIT F
SPREAD BETWEEN THE PRIME LOAN RATE AND THE PRIME CORPORATE PAPER RATE
PRIME LOAN RATE
PRIME CORPORATE PAPER RATE (30 DAY TERM)
SPREAD
6%
5%
4%
3%
2%
1%
0%
DEC. JAN. FEB. MAR. APR. MAY JUN. JUL. AUG. SEP. OCT. NOV.
1958
1959
1960
1961
1962

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX H

CHARTERED BANKS AND "NEAR BANKS"

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

CHARTERED BANKS AND "NEAR-BANKS"

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CHARTERED BANKS AND "NEAR-BANKS"

1. There is a close relationship between the business of the Investment Dealer and the Canadian banking community. Accordingly, it is of prime importance that the Investment Dealer keep abreast of, and closely in tune with, changes that occur in banking policies and practices that may in any way affect the market for, and best possible distribution of, investment securities. It is appropriate that full advantage be taken of the investigations being made by this Commission to outline the existing relationships between the Investment Dealer industry and the Chartered Banks and "Near-Banks", and to closely examine these relationships in a search for ways of improving the functioning of the whole capital market.

2. DEFINITIONS -- For the purposes of this presentation, we shall define --

(a) Chartered Banks ... as those Banks which come under the provisions of the Bank Act.

(b) Quebec Savings Banks ... as those Banks which come under the provisions of the Quebec Savings Bank Act.

(c) Near-Banks ... All other institutions which receive deposits (some times with chequing privileges) and/or make loans, e.g., Trust Companies, Mortgage and Loan Companies, Caisses Populaires, Credit Unions and, in some aspects of their operations, Finance Companies, Small Loan Companies, Provincial and Municipal Governments and Industrial and Commercial Corporations.

INVESTMENT DEALERS AS CUSTOMERS OF CHARTERED BANKS

(a) As borrowers

3. The nature of our business, involving periodic underwritings, and the carrying from day-to-day of large inventories of securities, requires large scale borrowing by way of, what are known as, call loans and day loans. These loans are secured by the deposit of securities pending sale or delivery. It is important that such loans be readily available at minimum cost.

4. The Chartered Banks at one time were virtually the only source of such funds. In recent years other sources have appeared and assumed growing significance.

5. Call loans and day loans to Investment Dealers carry a high credit rating involving a minimum risk. As evidence of their quality, the Bank of

Canada includes these loans in their banking statistics under the heading "More Liquid Assets", along with Bank of Canada Notes and deposits, Treasury Bills, Government Bonds and net Foreign Assets. They are a highly acceptable means of employing cash not immediately needed elsewhere.

6. The demand for these loans is constant in nature, although fluctuating some times widely, in amount.(1)

7. The revenue accruing to the Chartered Banks as well as to other lenders arising from interest charges on these loans is shown in Exhibit B.

8. A special scale of interest rates usually graduated upwards by several categories of collateral from the shortest term most liquid, to the longer term less liquid, is applied by the banks to such loans. These gradations are inferred to be related to market yield rates for such collateral, with appropriate changes made as circumstances warrant.

9. In practice, however, the dealers have found an element of rigidity built into these scales, particularly during periods of heavy demands for commercial loans (e.g., schedule unchanged from August 10, 1959 to October 11, 1960, remaining at flat 5¾% rate for all categories, except two, of collateral, although bond yields, as shown below, fell sharply during that period, e.g.,

Canada	3¾% Sept.1/65	Aug. 26, 1959	88 1/4	6.12%
		Sept.28, 1960	98 1/2	4.07
	4½% 1983	Aug. 26, 1959	87 3/8	5.45
		Sept.28, 1960	94 11/16	4.89)

During this same 14 months' period, the rediscount rate declined from 6.41% on Aug. 13, 1959 to 1.95% on Sept. 29, 1960.

10. Also the date, when these high rates were applied, virtually coincided with the date when bank general loans, having increased by 24% or $1,211 million between Oct. 1, 1958 and Aug. 19, 1959 levelled off and then declined between Aug. 19th and Dec. 31st, by $213 million. This downward trend continued during the first quarter and then turned upward again somewhat more than seasonally for the remainder of 1960. Throughout this period call loan rates remained unchanged.

11. It is recognized that Sec. 91 of the Bank Act and Sec. 71 (1) of the Quebec Savings Bank Act, placing a ceiling of 6% on the rate of interest banks may charge, inhibits the banks, in periods of excessive demand for loans, from using "price" as a restraint on general loan expansion, induces a type of

(1) See Exhibits A.1, A.2, A.3

loan rationing, and contributes to lack of flexibility when interest rates start to decline.

12. It must also be recognized, however, that this "price" factor, especially during the 14 months referred to above, did contribute directly to the development of a large and significant alternate source of short term funds for the Investment Dealer -- the so-called "Country Banks", an expression particular to our industry but for the purpose of this Brief included in the definition of "Near-Banks". The dealers, in the face of apparent indifference on the part of the Chartered Banks, sought out other sources of accommodation with no little success.

13. If the dealer could be satisfied that the call loan interest rates of the banks were subject to periodic review and appropriate action to keep them in line with market conditions, and competitive with non-bank rates, many of the call loans being obtained in the Country Banking System, in all probability, would revert to the Chartered Banks. Costs being reasonably close, the dealer, generally speaking, would prefer to keep his banking within Chartered Banking circles.

The ceiling on bank interest rates -- The Bank Act - Section 91

14. "Except as provided in subsection (2), no bank shall in respect of any loan or advance payable in Canada stipulate for, charge, take, reserve or exact any rate of interest or any rate of discount exceeding six per cent per annum and no higher rate of interest or rate of discount is recoverable by the bank." A similar restriction appears in Sec. 71 (1) of the Quebec Savings Bank Act.

15. We believe that this provision, in periods of financial stringency, prevents the banks from using "price" as a deterrent to undesirable loan expansion. When loaning resources become strained, the Banks must resort to a form of rationing, with the attendant dangers of discrimination as between different classes of borrowers.

16. The Near-Banks, to whom the ceiling does not apply, can use higher interest earnings to pay higher rates on deposits and so gain an advantage over the Chartered Banks.

17. Our Association believes that this interest ceiling should be removed, as was recommended in the McMillan Report 1933. Chapter VII para. 253 -- "Four of us are of opinion that a statutory maximum rate of interest

is nowadays anomalous and an undesirable interference with freedom of contract ..... by a majority, we recommend the repeal of the provision in question."

Investment Dealers as Customers of Chartered Banks (cont'd)

(b) As users of bank facilities to effect deliveries and complete transactions.

18. The Chartered Banking System provides the dealer with invaluable service facilities contributing materially to the quick, convenient completion of transactions and deliveries of securities.

19. There is, however, an area within this field, involving daylight overdrafts, where unacceptably high bank charges have led the dealer to devise a rather cumbersome but effective means of reducing the impact of these costs.

20. It is suggested that a joint committee of the I.D.A. and the C.B.A. might be constituted to which these and other problems of mutual concern could be referred for frank discussion and possible solution.

THE BANKS AS AN IMPORTANT SECTOR IN THE MARKET FOR SECURITIES

21. As a custodian of the bulk of the personal savings deposits of millions of Canadians, the manner in which these assets are employed is of major significance to the economy as a whole and certainly to the security markets.

22. At the end of 1945, savings deposits stood at $2,865 million. At the same time, Government of Canada and Provincial securities owned by the banks amounted to $3,586 million, of which $1,415 million were under two years in term.

23. By the end of 1946, personal savings had grown to $3,476 million, with the holdings of Canada and Provincial bonds rising to $3,693 million, of which $1,308 million were under two years in term.

24. This state of affairs led to an agreement effective March 1, 1946 on the part of the chartered banks with the Bank of Canada that their investments in Government of Canada, direct and guaranteed issues (other than Treasury Bills, Deposit Certificates and Treasury Notes), would not average more than 90% of the amount of their Canadian personal savings deposits. The banks also agreed that their earnings on such bonds should not exceed the cost of operating their savings business by more than a moderate profit margin.(1)

(1) Bank of Canada Report 1946 - page 14 ... Since cancelled as no longer necessary or desirable.

25. In the following year, there was a net decline of $170 million in Chartered Bank holdings of Government of Canada bonds, but their holdings of Provincial and Municipal securities increased by $159 million and their portfolio of other non-Government securities -- largely corporate debentures -- by $147 million. In that year, the Chartered Banks accounted for $316 million of a total of $327 million net increase in Canadian bonds and stocks outstanding.

26. The extent of the Chartered Banks' participation in the market for non-Government securities diminished in importance from this point onward, with other investors absorbing almost all the large net increase of non-Government securities.(1)

27. Since 1948, the Chartered Banks have employed an increasing proportion of deposits in commercial loans. It is only when the demand for short-term loans lessens that the banking system becomes a purchaser of securities. As a corollary, an increase in the demand for loans leads to the selling of securities by the banking system. The investment function is residual to the loaning function.

28. The attached statistics(2) show the security holdings by category of the chartered banks for the past sixteen years. As can be readily seen, the holdings of Government of Canada securities (including treasury bills) is by far the most volatile type of investment. In respect to holdings of Government of Canada securities beyond the two year area, it may be assumed that the vast majority mature within a five year period. In addition, maturity holdings beyond a ten year period are likely to be an exception. Generally, provincial holdings are well within the ten year maturity range. As to municipals, bank purchases fall within the 1 - 10 year range, the choice depending upon money position and interest in the municipality involved. The holdings of corporate securities are normally limited to under the ten year area, with, however, some exceptions being made for special bank clients. The acquisition of term corporation securities, wherein a chartered bank purchases all or a large portion of a private placement has, since 1955, been subject to restrictions arising out of an agreement amongst the Chartered Banks which has been varied from time to time in light of conditions. We concur in the desirability of these restrictions.

(1) See Statistical Table - Bank of Canada - Exhibit C
(2) Exhibit D

CHARTERED BANK INVESTMENT PRACTICES AND MONETARY POLICY

29. The residual nature of Chartered Bank investment policy subjects the market place to rather violent swings in security prices and yields. The effect is particularly evident in short term Government of Canada securities. An example of this effect, and the resultant effects on the whole interest rate structure, was evident in 1959 when the banking system, with demand for short term loans inordinately high, was a substantial seller of short term securities, thereby driving the yield of two year Canadas through 6%. During the following two years, the banking system was a net purchaser of short term securities and the yield on two year Canadas declined to as low as 3½%.

30. Referring to pages 27 - 31 of the Bank of Canada Report of 1956 (1) the Governor describes a serious weakness in the monetary control mechanism. The events of 1959 demonstrate the ineffectual use of monetary controls when the banking system has the liquidity to thwart the desired results of the control measures. The attached statistics (2) indicate that during the past eleven years, the Chartered Banks have placed an increasing percentage of their assets in Government of Canada securities maturing under two years. During the same period, a decreasing percentage of those assets have been invested in all securities maturing over two years. When considered in relation to personal savings deposits, the decline in the ratio of security holdings maturing over two years to personal savings deposits is evident. (3)

31. It is clear that the liquidity position of the banking system has been enhanced considerably during this period to the point where the desires of the monetary authorities might be effectively thwarted.

32. If it is considered desirable to attempt to reduce the long term interest rate on Canadian securities in order to moderate the flow of long term foreign investment, and, at the same time, establish the foreign exchange value of the Canadian dollar commensurate with the balance of trade position of the nation, the savings of the Canadian people would have to be mobilized to a maximum degree, and a proper proportion shepherded into the kind of investment naturally associated with long term savings. This suggests as an avenue of exploration the possibility that personal savings deposits held by the Chartered Banks, which have shown a steady upward trend (4), might be made available to a greater extent than at present is the case for long term investment.

(1) Exhibit E
(2) Exhibit D
(3) Exhibit F
(4) Exhibit F

33. This whole question is discussed at considerable length in the Bank of Canada Annual Report 1956.(1) The suggestions developed therein might well be examined in the light of present day conditions. In the words of that Report: "The possibility of a gradual approach towards arrangements of the sort outlined would seem to be worthy of study and discussion. Progress in such an approach would be directed towards expanding mortgage loans and other appropriate investments based on future increases in savings deposits, not reducing the volume of commercial or general loans."

THE CHARTERED BANKS AS ISSUERS OF SECURITIES

34. Though the chartered banks have offered term deposit receipts to their clients for a good number of years, it has been only during the past two years that the instrument has been an effective competitive vehicle in the market place. In severe competition for the funds of the large depositor ($100,000 plus) with the "near-banks", the chartered banks offer term deposit receipts at various rates for terms up to one year. The volume of such deposits is unknown but considered to be substantial. A number of chartered banks also offer term deposit receipts for terms of one to five years at competitive rates. On this type of paper, the chartered bank may pay a commission to the investment dealer which secures the funds on its behalf. Again, volume figures are not published. Another vehicle of investment that the banking system offers from time to time to the potentially large short-term depositor is what is usually called a U.S. Dollar Term Deposit. The chartered bank accepts the deposit at a given rate for a specific term, swaps the funds into U.S. dollars,with the profit or loss on the swap payable to the depositor, and invests the U.S. funds in the New York call loan market. This instrument has, at times, proven to be a highly competitive vehicle, wherein rates obtainable can be appreciably better than what is available in the domestic market for similar quality.

35. In respect to term deposit receipts maturing within one year, rates are established by agreement between banks. On a number of occasions in the past two years, it has been demonstrated that the rate changes have not responded quickly to market conditions. It is probable that this lack of responsiveness is being, and will be, corrected in the future. In the case of term deposits maturing over one year, rates are determined independently, governed by returns obtainable in the employment of these deposits.

(1) Exhibit E

THE BANKS AND NEAR-BANKS AS COMPETITORS

36. The Investment Dealer must regard as a competitor any person or agency that performs, or offers to perform, any of what the dealer regards as his functions. Outlined below are some of the ways, and extent to which, the Banks and Near-Banks appear to invade our field.

(a) In the Underwriting Field

Canada and Canada Guaranteed Issues

37. Just as the dealers are offered varying percentages of each issue on a "firm" basis, so are the chartered banks, usually at the same concession from the sale price to the public. Since these are drawn down for resale, they are underwritings. Bonds purchased for the banks' own portfolio requirements, at the time of issue, are of course taken at the full issue price.

Provincial and Provincial Guaranteed Issues

38. One or more chartered banks are included in each syndicate formed to bid for, or negotiate the purchase of, provincial or provincial guaranteed bonds. They take an active part in the discussions, and are influential in the decisions reached, regarding terms. The judgment of the bank which carries the banking account of the province concerned may carry especial weight, both as an adviser to the Province and within the syndicate. They participate in syndicate profits according to their established interest in the account, which interest is not necessarily supported by demonstrated placing power.

Municipals and Municipal Guaranteed Issues

39. As with provincial issues, one or more chartered banks are frequently included in the syndicate's bidding for, or negotiating the purchase of, municipal debenture issues, particularly in the case of large municipalities. Where serial issues are involved, and these are in the majority, the banking member or members of the syndicate not infrequently agree to purchase for their own account the early maturities. So the degree of enthusiasm shown by the banking members has a direct bearing on the price finally agreed upon.

40. Again, the banking members share, according to their interest, in any syndicate profits that emerge -- and again their interest in the syndicate does not necessarily bear a relationship to their contribution as a distributor.

Corporate Issues

41. The involvement of banks in underwriting of corporate issues is much less usual than in the case of government financing. The Bank Act[1]

(1) Para. 157 (2)

forbids the use of the name of any chartered bank "in a prospectus or advertisement for the sale of securities of any kind other than those issued by, or guaranteed as to principal and interest by, Canada". The Chartered Banks agreed in 1955 to "cease making new commitments for term lending, that is, making loans (in excess of \$250,000)[(1)] to business corporations where the time of repayment is deferred beyond that of ordinary bank loans, or purchasing a security negotiated directly with the customer as distinct from buying a publicly issued security in the market". (Bank of Canada Report 1956)

42. This Section of the Bank Act, and the agreement referred to, which agreement we understand has been renewed and somewhat expanded from time to time, clearly implies intended definite limitations as to the extent to which the chartered banks should venture into the field of distribution of securities other than those issued by governments, and into the corporate underwriting field.

43. Nonetheless, there are important instances where chartered banks are members of, and actively participate in the management of, syndicates formed for the purpose of underwriting securities of large corporations.

Comments on Banks as Members of Underwriting Syndicates

44. The question as to whether the public interest or any useful purpose is served through the inclusion of chartered banks in underwriting syndicates is one upon which there is considerable disagreement amongst our members. It is recognized that many of these arrangements were entered into many years ago, probably when there were good reasons for them. The Brief submitted by this Association to the Royal Commission on Banking and Currency in Canada in 1933 points out that immediately after the First War the capital requirements of governments, municipalities and industrial corporations were very large. Special arrangements were necessary to deal with them. The Brief stated: "Due to the size and number of issues offered, syndicates would include one or more banks as syndicate members, giving the bank (in addition to interest on the loan required) a share in the syndicate profits for its agreement to finance the issue pending distribution. It should be noted here that the bank's share of the profits was purely remuneration for carrying the loan and for its proportionate liability in the account, and the bank was not expected to, and in the early years did not, itself distribute bonds."

(1) Subsequently raised to \$1,000,000

45. The investment banking industry of those days was in the early stages of its development. It possessed only a small measure of the experience and financial strength that it has since acquired. Over the intervening years, the industry has matured and has demonstrated its ability to cope with the challenges with which it has been faced in meeting the capital needs of the Government of Canada, of other governments and public bodies, and of credit-worthy corporations. No longer is it necessary to hold out the golden carrot of a share of syndicate profits to obtain the banking accommodation it requires to fulfil its commitments. The fact remains that one or more chartered banks are members of most municipal syndicates of any size, of all of the provincial syndicates, and of a few of the important corporation syndicates.

46. Those of our members who take no exception to these arrangements maintain that the presence of banks in municipal syndicates adds strength to the bids where their banking partner agrees to absorb the early maturities. In provincial syndicates where the issues are set up on a fiscal agency basis, they acknowledge that the presence in the syndicates of the Province's bankers is helpful in negotiations. When negotiations are completed and liabilities taken, the assumption by the banking syndicate members of their share of the risks involved is reassuring to many of the syndicate members. During the process of distribution, the manner in which the banks deal with their participations may aid orderly distribution and lend stability to the after market.

47. In those relatively few cases of membership in corporate syndicates where the relationships are of relatively long standing, many of our members would not press to have these relationships disturbed. The majority of our members, however, would strongly discourage any extension of the practice.

48. Those of our members who object to the presence of chartered banks in underwriting syndicates support their position with these arguments:

(a) There are many possibilities of undesirable conflicts of interest arising out of intermingled customer relationships, particularly where the bank assumes the role of syndicate management.

(b) The primary function of the Chartered Banks is to provide for the short-term capital needs of its customers, whether public or private. The primary function of the Investment Dealer is to find long-term capital for both governments and corporations.

(c) It is in the public interest and important to the Chartered Banks themselves that the investment banking industry maintain a healthy growth

consonant with the growth of the country's economy. The curtailment of the dealer's field of activity through undue invasion and penetration by the Chartered Banks is bound to inhibit the growth and development of the investment dealer industry and so its ability to adequately perform its proper function within the economy.

49. The common ground within the conflicting points of view of our members is that there be no extension of the practice of including chartered banks within underwriting syndicates nor delegation to them of the management function.

The Banks and Near-Banks as Competitors

(b) In distribution of securities to the public

50. The Chartered Banks, and to a lesser but significant extent the Near-Banks, actively engage in the sale of securities to the public as agents and, not infrequently, as principals. They enjoy peculiar advantages over the dealers through their widespread branch systems, with only incidental distribution costs, and possessing knowledge of their customers' resources.

(1) As officially named and recognized agents and receiving the same selling commissions as the Dealers, the Chartered Banks and the Trust Companies participate in the distribution of Canada Savings Bond issues and in the newly emerged type of provincial parity bonds. It is worth noting that this type of distribution does not involve positions or risk, nor the exercise of investment judgment. In addition to selling commissions, the banks receive remuneration as issuing agents, thereby profiting from the successful efforts of the Dealers.

(2) As members of Selling Groups -- In those new issues where Selling Groups are formed, the usual procedure is to include all members of the I.D.A. and the Chartered Banks. This entitles the Banks to acquire the securities involved on the same basis as do the Dealers.

(3) As principals -- in issues where the Banks are members of underwriting syndicates. Here it is assumed that the Banks utilize their securities departments in the distribution of their participation. The Banks also, in a substantial way, act as principals in their secondary market operations.

Comments on Banks as distributors of securities to the public

51. It is recognized that the Canadian Chartered Banks with their comprehensive branch system, and intermingling in their operations as they do commercial and savings bank functions -- functions which elsewhere are usually separated -- have an advantage over the Dealer in reaching the potential investor at low and only incidental cost. Their effectiveness in Canada Savings Bond and similar campaigns is acknowledged, as is also their usefulness in serving the investment requirements of the customers of branches in small communities beyond the reach of investment houses. The Dealers, to offset these advantages, rely upon their specialized training and knowledge and concentration upon their particular functions.

52. In view of the reliance placed by the Chartered Banks on savings deposits as a funds source from which to expand commercial loans, there arises the question of conflict of interest, the conceivable tendency on the part of individual branch managers to discourage investment in order to maintain savings deposits. This could happen at the very time non-bank buyers are needed to absorb the pressure on the bond market of sales of securities by the banks to meet heavy demand for loans. At such times the burden of finding buyers falls on the investment dealer sales force and it is important that such sales force be available, in sufficient size, vigorous and resourceful enough, to do an effective job.

"NEAR-BANKS"

53. In our definitions, "near-banks" were described as institutions which perform one or more banking function, i.e. -- receive deposits and/or loan funds. As examples, we mentioned trust companies, caisses populaires, credit unions, finance companies, small loan companies, mortgage companies, corporations and provincial and municipal governments. Though it can be said that every financial intermediary performs one or more banking functions, the growth and the competitiveness evidenced in the above-mentioned institutions have made them subject to an increasing amount of comment in recent years.

54. We wish to discuss the relationship of these financial institutions to the investment dealer and to comment upon the impact on the financial framework of the nation consequent upon the growth in their resources.

RELATIONSHIP OF "NEAR-BANKS" TO INVESTMENT DEALER

(a) As Sources of Borrowed Capital

55. As a result of the inadequacy and cost of chartered bank accommodation during various periods in the last ten years, the trust company, the provincial and municipal government and the corporate entity have become important suppliers of demand and term funds to the investment industry. The volume of such loans is indicated in the weekly figures that have been collected by this Association since November of 1960. Were it not for the availability of these funds, there is little doubt the investment dealer costs would have been greater during the past three years.

56. As well as providing funds to investment dealers, the "near-bank" also provides short term funds to other financial intermediaries, e.g. -- corporate borrowers, finance companies and provincial and municipal governments. Although the volume of such loans outstanding at any one time is indeterminate, there is reason to believe that it would be very considerable.

(b) As Issuers of Securities

57. The "near-bank" offers a considerable variety of securities ranging from demand deposits to debentures, to deposit receipts, to certificates of deposits, to short term promissory notes and to secured or unsecured finance paper. Terms can vary from one day to five years and in size from $1,000 to millions of dollars. The securities are offered directly to the general public by some of these institutions, while others deal only through investment dealers, who act as principals or agents in the placement of these securities. Most of the "near-banks" attempt to secure their funds by both avenues. The investment dealer, when acting as an agent, obtains a commission for his service. When performing as a principal, the dealer re-offers the security at a price that will provide a profit.

58. There has been concern expressed in recent years as to the responsibility of the dealer in the placement of the securities of "near-banks". The pressure exerted within a firm to secure funds for a client have, undoubtedly, resulted in the placement of securities of dubious quality. We believe that the investment dealer must bear responsibility for the quality when the investing client is not in a position to judge the credit risk. The sophisticated investor requires no such protection. It is the belief of this Association that any rules and regulations in this respect could be easily circumvented.

(c) The "Near-Banks" as Clients

59. The growth in assets of some of the institutions included in the category "near-banks" is graphically represented in the attached exhibits. We have shown the substantial increase in bonds, mortgage and stock holdings of the trust and loan corporations and in the investments[1] of credit unions during the past ten years. The attached statistics for Canadian trust companies also demonstrate the substantial growth that has taken place in the past ten years in assets under administration, i.e. -- estates, trusts and agency funds. When it is considered that these statistics cover the assets of only certain of the "near-banks", it is evident that these institutions have a significant impact on the marketplace.

QUEBEC SAVINGS BANKS

The attached statistics[2] show the extent to which the assets of the Quebec Savings Banks are invested in Canadian securities.

(1) No published breakdown of these investments is available covering all credit unions but the Province of Quebec report on Caisses Populaires for 1960 indicates that over 75% of the total investments of all credit unions were held by the "Caisses" of that Province, distributed as follows:

Canadian Government Bonds	$ 24,092,466
Provincial Government Bonds	34,905,525
Municipal or School Corporation Bonds	105,800,943
Church Fabric Bonds, Ecclesiastic and Religious Corporation Bonds	47,226,664
Total	$212,025,598

(2) Exhibit I

RECOMMENDATIONS

It is recommended to the Commission that consideration be given to the following suggestions:

Pr. 3 page 1 to Pr. 13 page 3

(1) that the chartered banks adopt policies and procedures designed to satisfy the investment dealers that their call loan interest rate schedules are to be subject to periodic review and appropriate action to keep them in line with market conditions and competitive with the rates under which similar loans may be obtained from non-bank sources.

Pr. 14 page 3 to Pr. 17 page 3

(2) that Section 91 of the Bank Act and Section 71 (1) of the Quebec Savings Bank Act, imposing a ceiling of 6% on the rate which may be charged upon bank loans, be repealed as being "an undesirable interference with freedom of contract".

(3) that every encouragement should be given to the continued healthy development of the Investment Dealer's ability to perform satisfactorily the important underwriting function and in particular -

Pr. 28 page 5 and Pr. 41 page 8 to ~~xxxxx~~ Pr. 42 page 9

(a) that the banks continue to refrain from making term loans (in excess of a reasonable limit in amount) to business corporations where the time of repayment is deferred beyond that of ordinary bank loans, or purchasing a security negotiated directly with the customer as distinct from buying a publicly issued security in the market.

Pr. 44 page 9 to Pr. 49 page 11

(b) that there should be no further extension, beyond the relatively few cases of long standing which may exist, of the inclusion of banks in syndicates underwriting corporate securities for resale to the public, particularly where such inclusion would place the bank in the dual position of banker and underwriter and where the sale of corporate securities is for the purpose of paying off bank loans.

EXHIBITS

A.	Graph 1	Investment Dealer Call Loans and Day Loans placed with Chartered Banks
	Graph 2	Investment Dealer Call Loans and Day Loans placed with "Country Banks"
	Graph 3	Investment Dealer Call Loans and Day Loans -- Total
B.		Revenue accruing to Chartered Banks and other lenders from Call and Day Loans
C.	Table	Changes Security Portfolios of Chartered Banks related to Net Issue or Retirement of Canadian Bonds and Stocks (Bank of Canada Report 1949 - page 7)
D.		Selected Chartered Bank Statistics
	Table 1	Earnings and Balance Sheet Items 1952 - 1961
	" 2(a)	Distribution of Investment Holdings 1946 - 1953
	" 2(b)	Distribution of Investment Holdings 1954 - 1961
E.		Bank of Canada Report 1956 (pages 27-31)
F.	Graph	Canadian Chartered Bank Investment Holdings related to Personal Savings Deposits and Loans
G.	Graph 1	Trust Companies Loan Corporations
		Statistics re above
	Tables 1 - 4	Trust Companies
	" 5 & 6	Loan Corporations
H.		Credit Unions
	Table -	Balance Sheet Items 1951-1960
I.		Quebec Savings Banks
	Table -	Balance Sheet Items 1951-1960

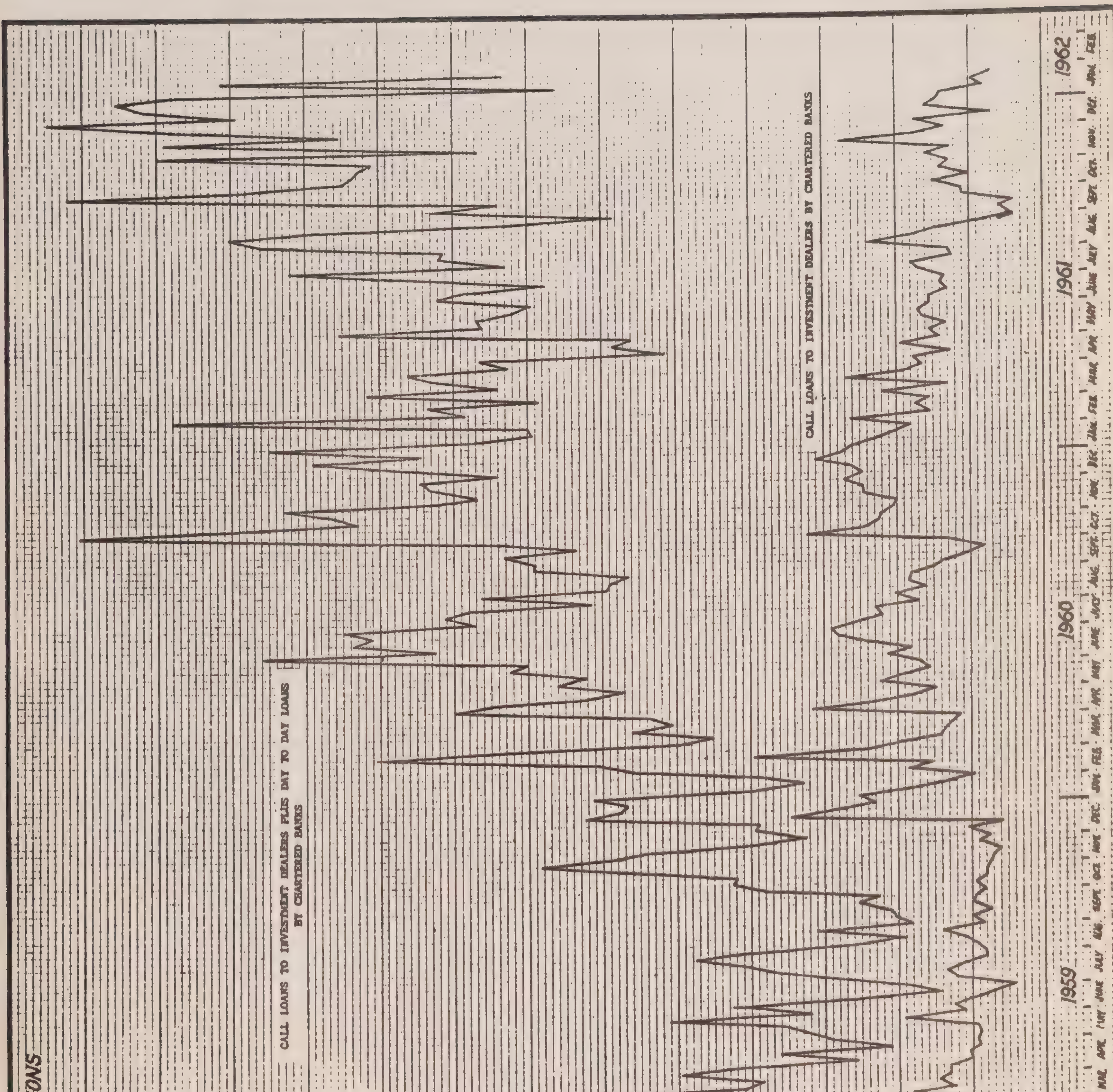
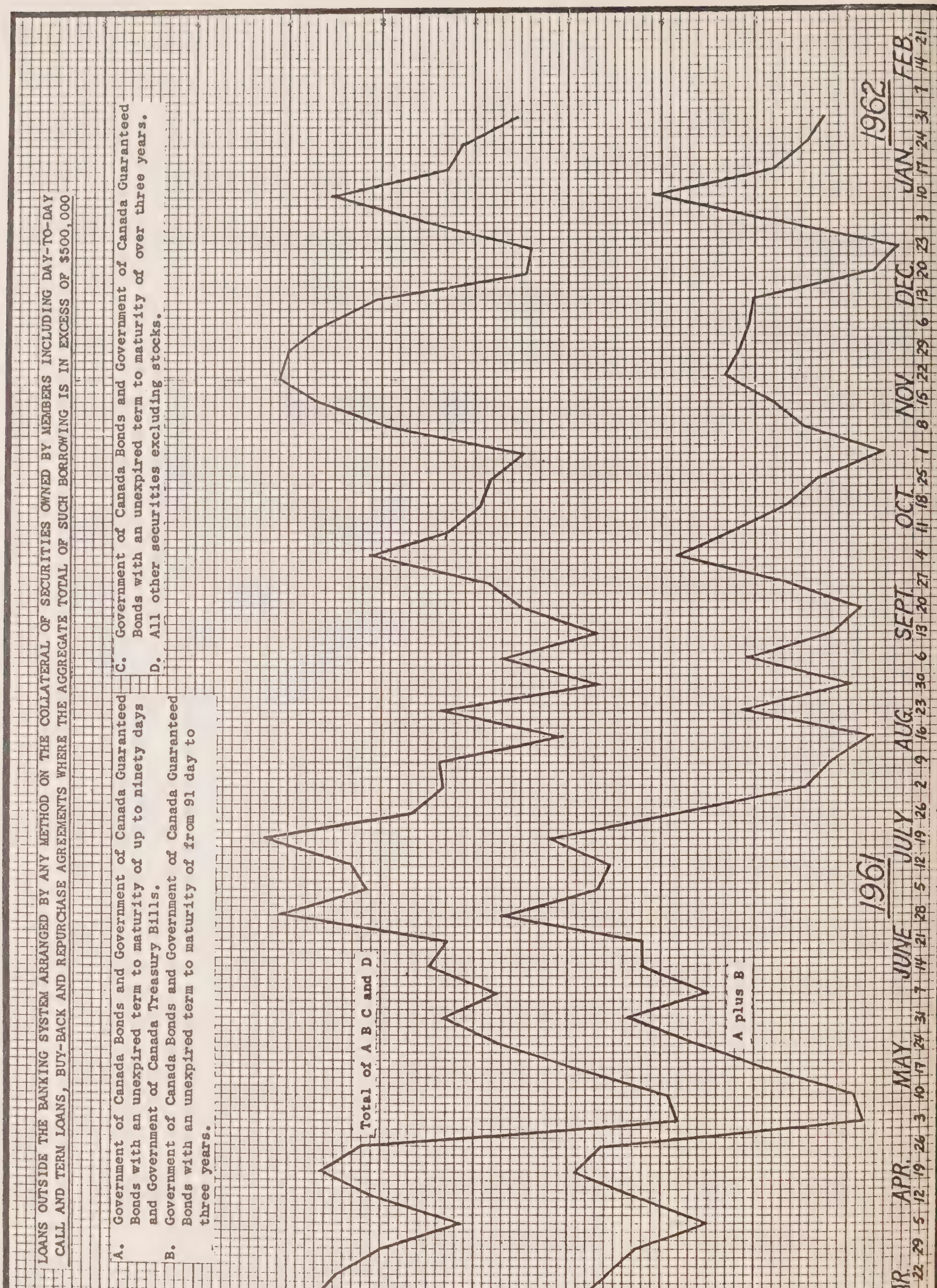
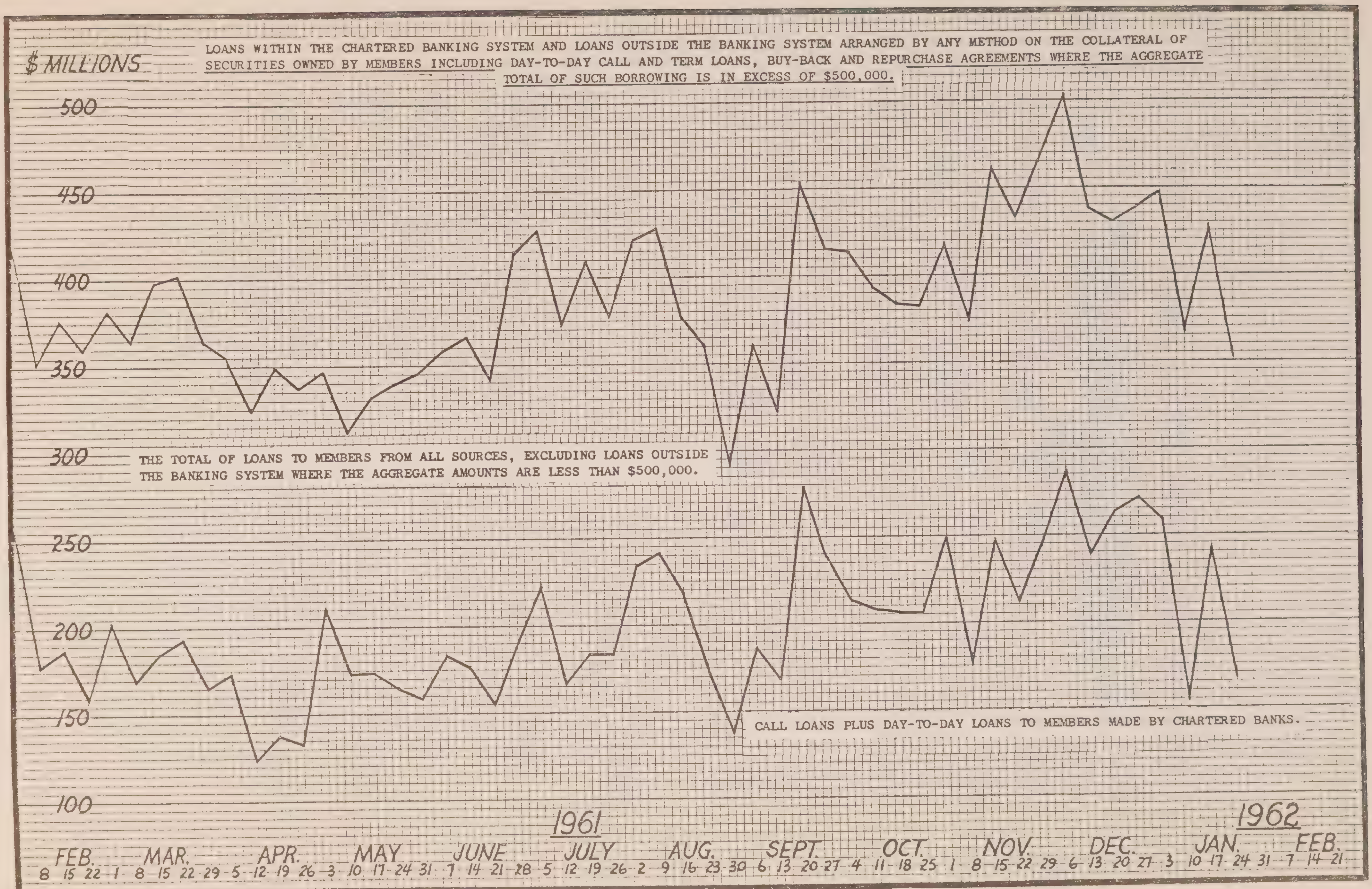

$ MILLIONS
280
260
240
220
200
180
160
140
120
100
80
60
40
20
CALL LOANS TO INVESTMENT DEALERS PLUS DAY TO DAY LOANS
BY CHARTERED BANKS
CALL LOANS TO INVESTMENT DEALERS BY CHARTERED BANKS
1959
1960
1961
1962

EXHIBIT A
Graph 2




$ MILLIONS
LOANS WITHIN THE CHARTERED BANKING SYSTEM AND LOANS OUTSIDE THE BANKING SYSTEM ARRANGED BY ANY METHOD ON THE COLLATERAL OF SECURITIES OWNED BY MEMBERS INCLUDING DAY-TO-DAY CALL AND TERM LOANS, BUY-BACK AND REPURCHASE AGREEMENTS WHERE THE AGGREGATE TOTAL OF SUCH BORROWING IS IN EXCESS OF $500,000.
500
450
400
350
300
250
200
150
100
THE TOTAL OF LOANS TO MEMBERS FROM ALL SOURCES, EXCLUDING LOANS OUTSIDE THE BANKING SYSTEM WHERE THE AGGREGATE AMOUNTS ARE LESS THAN $500,000.
CALL LOANS PLUS DAY-TO-DAY LOANS TO MEMBERS MADE BY CHARTERED BANKS.
1961
1962
FEB. MAR. APR. MAY JUNE JULY AUG. SEPT. OCT. NOV. DEC. JAN. FEB.
8 15 22 1 8 15 22 29 5 12 19 26 3 10 17 24 31 7 14 21 28 5 12 19 26 2 9 16 23 30 6 13 20 27 4 11 18 25 1 8 15 22 29 6 13 20 27 3 10 17 24 31 7 14 21

REVENUE ACCRUING TO CHARTERED BANKS AND OTHER LENDERS FROM INTEREST ON LOANS, AND SERVICES PROVIDED, TO MEMBERS OF THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

YEAR ENDED DECEMBER 31, 1961

	Chartered Banks	Other Lenders
Interest on "Call Loans"	$ 4,522,548	$ 2,313,335
Interest on Short Term and Day Loans	3,656,621	3,225,230
Overcertification Charges	581,500	
Miscellaneous Charges (including drafts, delivery charges, etc.)	705,970	
TOTAL	$ 9,466,639	$ 5,538,565

Number of Members Reporting	186	186
Number of Members Reporting Nil	9	106
Number of Members Involved	177	80

EXHIBIT C

Type of Security	Net Issue or Retirement of Canadian Bonds and Stocks (3)					Net Increase or Decrease in Security Portfolios of Chartered Banks				
	1945	1946	1947	1948	1949	1945	1946	1947	1948	1949
Provincial	28*	18*	65	199	339	22	2	151	8	30x
Municipal	43*	5*	31	71	89	15	24	18	7	21
Corporation	25	68	231	260	211	23	88	147	98	68x
Total	46*	45	327	530	639	60	114	316	113	77x

* Retirement
x Decrease

(3) Source: Appendix A, page 29. The table understates the total volume of net new issues of these securities in the Canadian market by the amount of the net reduction of foreign holdings of such securities through retirement or refunding.

Above from Bank of Canada Report 1949.

EXHIBIT D
Table 1

CANADIAN CHARTERED BANKS (as at October 31st)

Earnings ($ millions) (1) (2)	1961	1960	1959	1958	1957	1956	1955	1954	1953	1952
Loans	540.5	525.5	455.1	386.9	380.6	314.2	236.3	219.3	191.6	166.3
Securities	196.6	182.3	169.4	160.5	118.4	102.8	128.4	124.3	111.4	100.8
Other	143.1	134.6	122.3	126.0	109.5	96.5	89.0	81.9	75.5	70.0
Operating Earnings	880.2	842.4	746.8	673.4	608.5	513.5	453.7	425.5	378.5	337.1
Operating Profit	209.5	214.9	178.4	167.8	137.0	125.1	111.7	113.3	109.8	84.3
Other Income	1.5	3.7	3.3	1.5	.4	3.1	(.6)	1.8	(.4)	--
Net Earnings	211.0	218.6	181.7	169.3	137.4	128.2	111.1	115.1	109.4	84.3
Depreciation	19.6	18.4	16.4	14.3	12.7	11.4	10.1	9.0	7.1	7.0
Losses & Add. Inner Res. Net	(10.6)	25.2	32.3	16.0	2.8	14.1	22.5	(32.9)	24.9	27.3
Taxes	101.7	90.7	65.2	69.6	56.6	41.7	37.2	58.0	30.1	25.5
Net Profit	100.3	84.3	67.8	69.4	65.3	61.0	41.3	81.0	47.3	24.5
Cash Flow	109.3	127.9	116.5	99.7	80.8	86.5	73.9	57.1	79.3	58.8
Dividends	57.8	54.0	47.6	40.0	35.4	31.9	26.2	21.5	20.4	18.6
Additions to Shareholders' Equity										
Capital:										
- New Issues	9.4	11.5	31.7	10.5	16.5	14.2	13.7	16.2	2.3	0.4
Rest Account:										
- Undivided Profits	14.5	16.8	9.0	14.2	8.0	15.9	8.7	9.0	16.1	(10.5
- Retransfers from Inner Res.	27.1	15.7	8.5	16.8	18.7	19.0	4.0	48.0	17.0	(
- Premium on Shares	14.6	36.2	72.9	28.6	33.3	42.1	19.8	29.9	1.9	0.5
Undivided Profits:										
- Undivided Profits (from oper. earn. net after transfers to rest acct.)	1.0	(2.2)	2.7	(1.5)	3.2	(5.7)	2.4	2.5	(6.1)	(4.6)
Net Additions	66.6	78.0	124.7	68.6	79.7	85.5	48.6	105.7	31.2	6.7
Balance Sheet ($ millions) (3)										
Assets:										
Cash Resources										
- Canadian	1,919.5	1,892.6	1,829.9	1,996.8	1,756.6	1,731.4	1,683.1	1,453.6	1,624.2	1,467.9
- Foreign	1,050.4	704.7	451.0	494.8	435.8	401.0	335.7	319.9	320.0	324.8
- Total	2,969.9	2,597.3	2,280.9	2,491.6	2,192.4	2,132.4	2,018.8	1,773.5	1,944.2	1,792.7
Securities										
- Canadian	4,781.4	4,142.6	3,882.8	5,025.4	3,523.1	3,583.1	4,493.9	4,132.2	3,561.0	3,914.4
- Foreign	835.9	723.6	527.8	589.6	431.8	371.1	299.7	310.0	227.9	232.7
- Total	5,617.3	4,866.2	4,410.6	5,615.0	3,954.9	3,954.2	4,793.6	4,442.3	3,788.9	4,147.1
Call Loans, etc.										
- Canadian	338.5	289.7	236.8	247.5	246.8	227.9	232.6	293.3	143.8	130.1
- Foreign	882.4	958.8	788.8	646.8	561.2	340.7	213.3	219.0	207.8	144.7
- Total	1,220.9	1,248.5	1,025.6	894.3	808.0	568.6	445.9	512.3	351.6	274.8
Total Liquid Assets	9,808.1	8,712.0	7,717.1	9,000.0	6,955.3	6.655.2	7,258.3	6,728.1	6,084.7	6,214.6
Loans Ex Call Loans										
- Canadian	6,483.3	6,127.8	6,109.0	5,034.5	5,232.7	5,223.3	4,442.9	3,894.0	3,839.9	3,213.8
- Foreign	918.0	827.3	762.4	620.6	454.5	360.0	332.6	281.7	258.7	262.8
- Total	7,401.3	6,955.1	6,871.4	5,655.1	5,687.2	5,583.3	4,775.5	4,175.7	4,098.6	3,476.6
Mortgages	955.0	977.7	944.7	743.1	551.7	471.3	235.5	38.3	.4	.4
Miscellaneous	648.6	580.4	480.2	471.0	451.4	394.2	360.0	303.2	322.7	350.1
	18,813.0	17,255.2	16.013.4	15.870.2	13.645.6	13,104.0	12,629.3	11,245.3	10,506.4	10,041.7
Extract:										
Primary and Secondary Reserves										
- Notes of and Deposits in the Bank of Canada	1,120.9	1,005.0	960.4	952.3	895.6	884.3	858.3	815.5	N.A.	N.A.
- Call Loans, etc. (4)	338.5	289.7	236.8	247.5	246.8	227.9	232.6	293.3	N.A.	N.A.
- Gov't. of Can. Treas. Bills	1,269.8	1,015.5	912.2	985.6	830.3	791.1	337.4	371.5	N.A.	N.A.
	1,608.3	1,305.2	1,149.0	1,233.1	1,077.1	1,019.0	570.0	664.8	N.A.	N.A.
Canadian Liquid Reserves	2,729.2	2,310.2	2,109.5	2,185.4	1,972.7	1,903.3	1,428.3	1,480.3	N.A.	N.A.
Liabilities:										
Canadian Deposits										
- Savings	7,853.4	7,424.7	7,236.9	7,009.8	6,225.0	6,098.2	5,838.7	5,337.2	5,147.7	4,900.9
- Demand	5,348.2	4,827.8	4,643.5	5,083.8	4,315.5	4,298.9	4,449.6	3,704.1	3,151.9	3,067.8
- Other	402.9	525.5	394.8	516.4	374.5	462.2	494.4	526.1	590.2	489.0
- Total	13,604.5	12,778.0	12,275.2	12,610.0	10,915.0	10,859.3	10.782.7	9,567.4	8,889.8	8,457.7
Foreign Deposits	3,715.5	3,052.3	2,529.2	2,166.9	1,713.4	1,334.3	1,048.4	985.8	1,029.0	987.9
Total Deposits	17,320.0	15,830.3	14.804.4	14,776.9	12,628.4	12,193.6	11,831.1	10.553.2	9,918.8	9,445.6
Miscellaneous	438.4	397.0	291.0	304.1	306.3	263.8	238.6	197.5	191.9	218.0
- Capital	274.9	265.4	253.9	222.2	211.7	195.2	181.0	167.0	151.0	148.6
- Rest Account	771.0	725.8	653.9	559.8	490.0	445.2	367.3	318.3	236.9	216.6
- Undivided Profit	8.7	6.7	10.2	7.2	9.2	6.2	11.3	9.3	7.8	12.9
Total Equity	1,054.6	997.9	918.0	789.2	710.9	646.6	559.6	494.6	395.7	378.1
	18,813.0	17,225.2	16,013.4	15,870.2	13,645.6	13,104.0	12,629.3	11,245.3	10,506.4	10,041.7

(1) In 1960 five banks ended their financial year on Oct. 31st, two on Nov. 30th, and one on Sept. 30th. (2) Source: Bank of Canada Annual Statistical Summary. (3) Source: Canada Gazette. (4) Includes secured day-to-day, call and short loans to investment dealers and brokers in Canadian Currency. Secondary reserves, however, normally exclude all but day-to-day loans in this total.

SELECTED CHARTERED BANK STATISTICS (000's omitted)

	1953	1952	1951	1950	1949	1948	1947	1946
Gov't. of Can. Treas. Bills	244,000	138,000	236,000	129,000	126,000	129,000	139,000	147,000
Gov't. of Can. Sec. Mat. 2 yrs.	482,000	869,000	499,000	694,000	763,000	656,000	482,000	1,052,000
Total	726,000	1,007,000	735,000	823,000	889,000	785,000	621,000	1,199,000
Gov't of Can. Sec. Maturing after 2 years	2,033,774	1,777,217	2,019,211	2,256,182	2,223,556	2,173,159	2,027,698	2,117,555
Cdn. Provincial Securities	334,339	379,052	355,121	415,586	445,316	475,704	467,745	316,449
Cdn. Municipal Securities	151,880	159,377	167,270	193,704	161,262	139,935	133,292	115,462
Other Cdn. Securities	348,696	377,413	399,296	405,277	383,549	451,603	353,855	207,188
Total	3,595,082	3,700,021	3,675,426	4,093,500	4,102,490	4,026,189	3,603,116	3,956,304
Char. Banks Total Assets	10,722,306	10,157,350	9,609,802	9,495,936	8,718,188	8,579,518	7,973,986	7,798,628
Gov't. of Can. Treas. Bills % Char. Bank Total Assets	2.28	1.36	2.46	1.36	1.45	1.50	1.74	1.88
Gov't. of Can. Sec. Mat. 2 yrs. % Char. Bank Total Assets	6.77	9.91	7.64	8.66	10.19	9.16	7.78	15.38
Gov't. of Can. Sec. Mat. after 2 years % Char. Bank Total Assets	18.97	17.50	21.01	23.76	25.50	25.33	25.43	27.15
Cdn. Prov. Securities % Char. Bank Total Assets	3.19	3.73	3.70	4.38	5.11	5.54	5.87	4.06
Cdn. Mun. Securities % Char. Bank Total Assets	1.42	1.57	1.74	2.04	1.85	1.63	1.67	1.48
Other Cdn. Securities % Char. Bank Total Assets	3.25	3.72	4.16	4.27	4.40	5.26	4.44	2.66
Char. Bank Total Securities % Total Assets	33.53	36.43	38.25	43.11	47.06	46.93	45.19	50.73
Gov't. of Can. Treas. Bills & Sec. Mat. within 2 yrs. % Char. Bks. Total Assets	6.77	9.91	7.64	8.66	10.19	9.16	7.78	15.38
Char. Banks Holdings of all Sec. except Treas. Bills and Canadas Mat. under 2 years	2,868,689	2,693,059	2,940,898	3,270,749	3,213,683	3,240,401	2,982,590	2,756,654
Char. Banks Holdings of all Sec. + Mtges. except Treas. Bills & Cdas. Mat. under 2 years	2,869,098	2,693,505	2,941,284	3,271,205	3,214,353	3,241,347	2,983,805	2,758,302
Char. Bks. Holdings of all Secs. + Mtges. except Treas. Bills and Cdas. Mat. under 2 yrs. % Pers. Sav. Dep.	56.99	54.70	63.78	71.76	72.50	79.90	79.77	79.51
Personal Savings Deposits	5,034,050	4,924,489	4,611,524	4,558,417	4,433,352	4,056,953	3,740,442	3,469,322
Demand Deposits	3,180,050	3,242,094	2,962,711	2,770,388	2,426,477	2,543,617	2,295,585	2,290,809
Other Deposits	849,713	412,493	481,433	616,622	461,462	464,018	404,874	516,602
Total Deposits	9,063,813	8,579,076	8,055,668	7,945,427	7,321,291	7,064,588	6,440,901	6,276,733
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Pers. Sav. Dep.	56.99	54.69	63.77	71.75	72.49	79.87	79.74	79.46
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Demand Deposits	90.21	83.07	99.26	118.06	132.44	127.39	129.93	120.34
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Total Deposits	31.65	31.39	36.51	41.17	43.90	45.87	46.31	43.92
Char. Bks. Holdings of all Secs. + Mtge. except Treas. Bills & Cdas. Mat. under 2 yrs. % Total Deposits	31.65	31.40	36.51	41.17	43.90	45.88	46.33	43.94

E. & O. E.

EXHIBIT D
Table 2(b)

SELECTED CHARTERED BANK STATISTICS (000's omitted)

	1961	1960	1959	1958	1957	1956	1955	1954
Gov't. of Can. Treas. Bills	1,156,888	967,209	973,807	949,705	804,964	739,600	427,464	359,799
Gov't. of Can. Sec. Mat. 2 years	1,088,500	615,288	657,484	826,069	409,853	406,096	475,089	635,592
Total	2,245,388	1,782,497	1,631,291	1,775,774	1,214,817	1,145,696	902,553	995,391
Gov't of Can. Sec. Maturing after 2 years	1,550,743	1,472,389	1,169,260	1,736,016	1,425,370	1,268,933	2,156,877	2,317,562
Cdn. Provincial Securities	351,980	323,819	346,168	415,151	285,011	268,981	322,478	263,508
Cdn. Municipal Securities	231,264	207,962	204,154	194,723	168,273	184,694	217,658	177,312
Other Cdn. Securities	470,319	473,009	512,401	553,994	508,753	510,112	481,916	353,332
Total	4,849,694	4,059,676	3,863,274	4,675,658	3,602,224	3,378,416	4,081,482	4,107,105
Char. Banks Total Assets	19,153,484	16,917,096	15,834,924	15,840,274	14,243,504	13,427,896	12,701,736	11,433,157
Gov't. of Can. Treas. Bills % Char. Bank Total Assets	6.04	5.72	6.15	6.00	5.65	5.51	3.37	3.15
Gov't. of Can. Sec. Mat. 2 years % Char. Bank Total Assets	5.68	3.64	4.15	5.21	2.88	3.02	3.74	5.56
Gov't of Can. Sec. Mat. after 2 years % Char. Bank Total Assets	8.10	8.70	7.38	10.96	10.01	9.45	16.98	20.27
Cdn. Prov. Securities % Char. Bank Total Assets	1.84	1.91	2.19	2.62	2.00	2.00	2.54	2.30
Cdn. Mun. Securities % Char. Bank Total Assets	1.21	1.23	1.29	1.23	1.18	1.38	1.71	1.55
Other Cdn. Securities % Char. Bank Total Assets	2.46	2.80	3.24	3.50	3.57	3.80	3.79	3.09
Char. Bank Total Securities % Total Assets	25.32	23.99	24.40	29.52	25.29	25.16	32.13	35.92
Gov't. of Can. Treas. Bills & Sec. Mat. within 2 yrs. % Char. Bks. Total Assets	11.72	10.54	10.30	11.21	11.73	8.53	7.11	8.71
Char. Banks Holdings of all Sec. except Treas. Bills and Canadas Mat. under 2 years	2,604,306	2,277,179	2,231,983	2,899,884	2,387,407	2,232,720	3,178,929	3,111,714
Char. Banks Holdings of all Secs. + Mtges. except Treas. Bills & Cdas. Mat. under 2 yrs.	3,556,977	3,247,771	3,199,853	3,689,613	2,973,213	2,725,897	3,472,592	3,185,954
Char. Banks Holdings of all Secs. + Mtges. except Treas. Bills and Cdas. Mat under 2 yrs. % Pers. Sav. Dep.	46.69	45.02	46.38	53.91	48.68	45.38	61.65	61.06
Personal Savings Deposits	7,618,100	7,214,692	6,899,639	6,843,687	6,107,930	6,007,180	5,632,752	5,217,717
Demand Deposits	5,629,516	4,877,215	4,701,895	5,254,311	4,642,988	4,624,522	4,378,845	3,994,596
Other Deposits	938,363	820,268	677,598	592,219	656,104	530,637	836,520	470,493
Total Deposits	14,185,979	12,912,175	12,279,132	12,690,217	11,407,022	11,162,339	10,848,117	9,682,806
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat under 2 yrs % Pers. Sav. Dep.	34.19	31.56	32.35	42.37	39.09	37.18	56.44	59.64
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Demand Deposits	46.26	46.69	47.47	55.19	51.42	48.28	72.60	77.90
Char. Bks. Holdings of all Sec. except Treas. Bills & Cdas. Mat. under 2 yrs. % Total Deposits	18.36	17.64	18.18	22.85	20.93	20.00	29.30	32.14
Char. Bks. Holdings of all Secs. + Mtge. except Treas. Bills & Cdas. Mat. under 2 yrs. % Total Deposits	25.07	25.15	26.06	29.07	26.06	24.42	32.01	32.90

EXHIBIT "E"

EXCERPT FROM THE BANK OF CANADA ANNUAL REPORT 1956

THE BANKING SYSTEM

1. One reason why it is not possible to predict the effects of monetary measures with accuracy is the uncertainty, which must always exist to some degree, as to the reaction of the banking system itself to such measures. In Canada this has been more noticeable perhaps than elsewhere because of the extent to which commercial banking functions and savings banking functions are intermingled in the operations of the chartered banks. Over 80% of total personal savings deposits in Canada are held with the chartered banks, and the pattern of investment of such deposits has varied widely at different times. The banks may under conditions of inflationary pressure expand their commercial and general loans and other forms of short-term credit from such funds, which in other times would go into long-term investments, including (since 1954) housing loans. This has happened in each of the postwar credit expansion cycles (1947-48, 1950-51, 1952-53 and 1955-56).

2. The possibility of such a development has made it necessary for the central bank to regard the total volume of deposits of the chartered banks, including personal savings deposits, as forming part of the money supply, whereas the savings deposits held with specialized savings institutions (e.g. trust companies, loan companies, savings banks, credit unions) are not so regarded. At a time of strong demand for short-term credit, therefore, the central bank must endeavour to restrain any increase in total bank deposits, to such a degree that the natural and virtually unavoidable increase in personal savings deposits is largely or at times entirely matched by a decline in other deposits.

3. Even so, the effects on credit expansion of any particular degree of restraint on monetary expansion cannot be predicted with confidence, because of the availability for commercial and general loans of funds that can be obtained by the banks by selling in large volume the Government securities in which a considerable proportion of their savings deposits had previously been invested. By this means, the greater part of the resources of the banks' savings departments have been available as required from time to time to augment the other resources of the banks' commercial banking departments when the demand for commercial loans has been particularly great.

Housing loans and other investments have been the residual form of investment for the savings departments of the banks.

4. In other countries personal savings deposits are chiefly held by separate and specialized institutions, sometimes called building societies, sometimes called savings and loan associations, sometimes called savings banks or mutual savings banks, which make a practice of investing such funds in housing loans and in relatively long-term securities. Their objective is to invest to the best advantage in order to obtain the largest revenue consistent with prudent investment practices, and in order thereby to be able to pay the highest possible rate of interest to their depositors. Experience has shown that rarely if ever does a savings institution encounter an actual decline in its total volume of deposits, other than purely temporary or seasonal fluctuations which a reasonable degree of liquidity in its assets will permit it to meet without having to run the risk of losses through sales of long-term investments prior to maturity. The great bulk of personal savings deposits, increasing from year to year, are accordingly invested in non-commercial-banking types of loans and investments, and the central bank does not regard such deposits as part of the supply of "money" that need be directly influenced by monetary operations.

5. The different evolution of the Canadian banking structure has created problems relating both to fluctuations in short-term credit and to fluctuations in long-term investment. Until 1954 the Canadian chartered banks were not permitted by law to lend money on housing or other forms of real estate, presumably because they were primarily regarded as commercial banks. Because of their efficient operation of a widespread branch system in a large sparsely settled country they managed to attract most of the personal savings deposits of the people, and these became increasingly important as the country developed. The increase in the chartered banks' savings deposits has averaged $340 million a year over the last five years and will no doubt continue to rise in the future. Specialized savings institutions grew much more slowly, and mainly in the large cities. The kind of investments such institutions might have made were for the most part not made by the chartered banks.

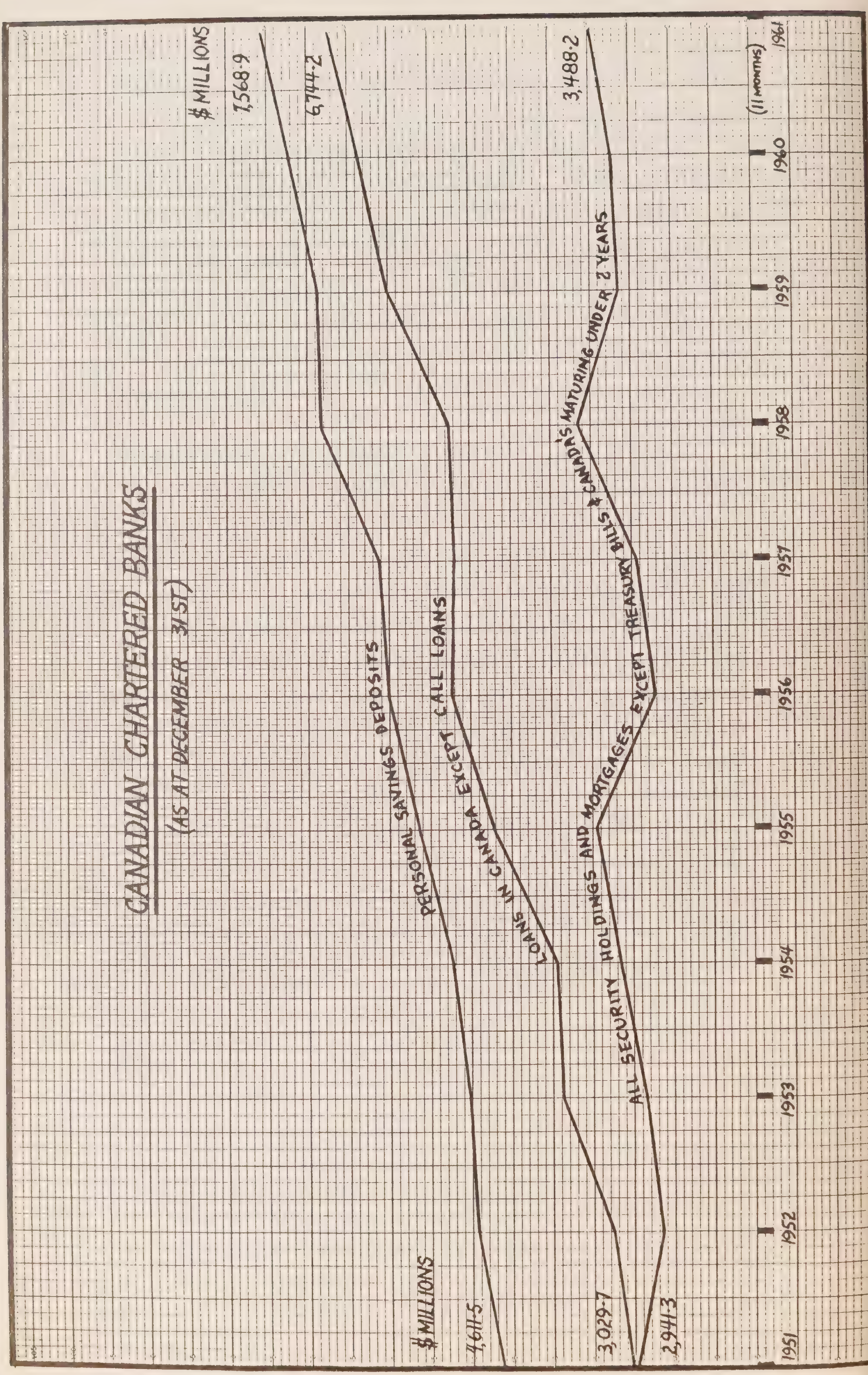
6. In 1954 the Bank Act was amended to permit the chartered banks to make mortgage loans on new houses, loans insured under the National Housing Act. This was an important improvement in the machinery of the Canadian capital market. I believe it would be desirable if means could now be found to encourage greater

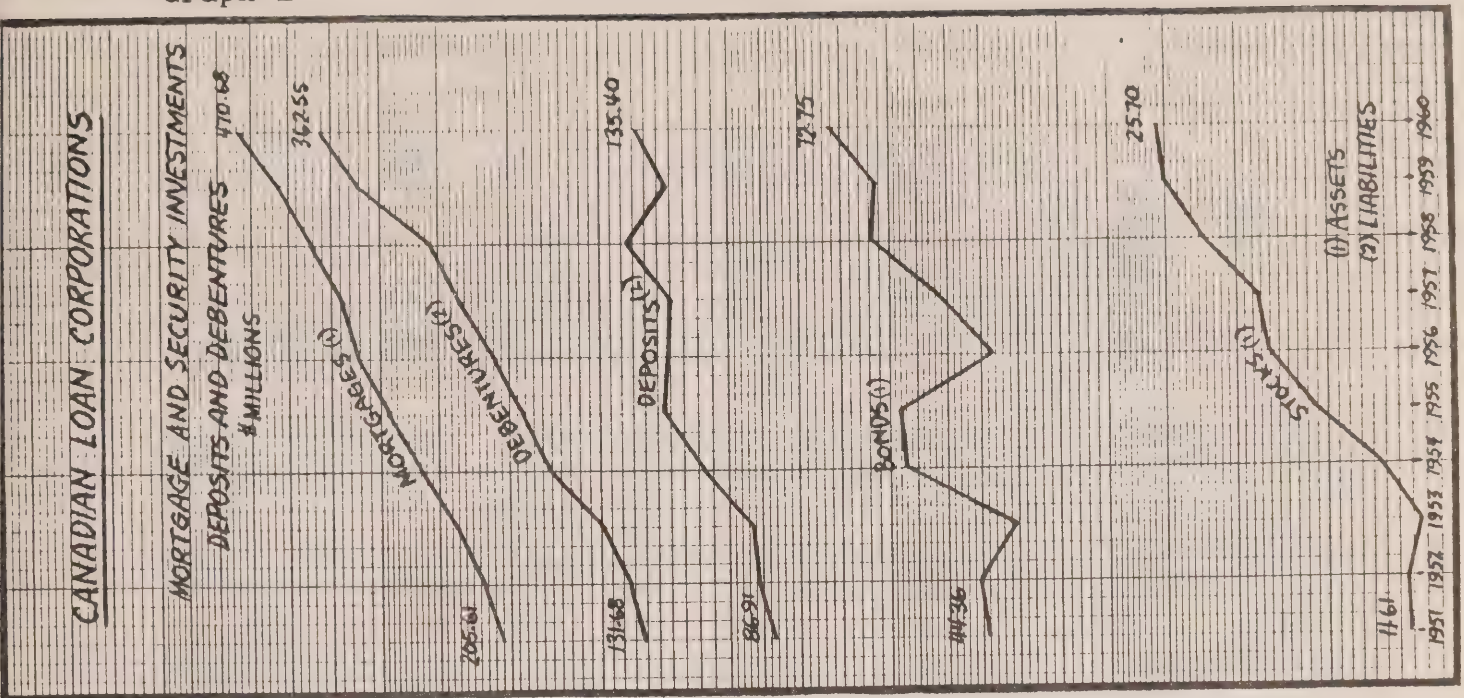
stability in the rate of long-term investment by the banks in those fields where they may now operate.

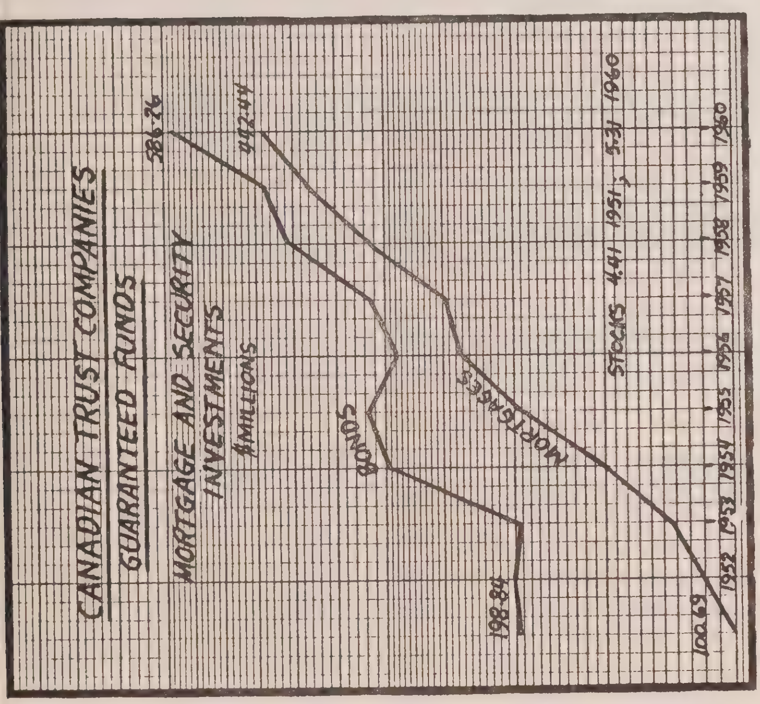
7. It may be that specialized savings institutions, which invest their fund in housing loans and other long-term investments and are able thereby to pay higher rates of interest on savings deposits than the chartered banks, will grow in importance and attract a growing part of the future personal savings of Canadians. To maintain their relative position, the chartered banks may find it desirable and necessary to operate in respect of the resources of their savings departments in much the same way as a savings bank and use such resources to provide funds for the kinds of investment naturally associated with long-term savings.

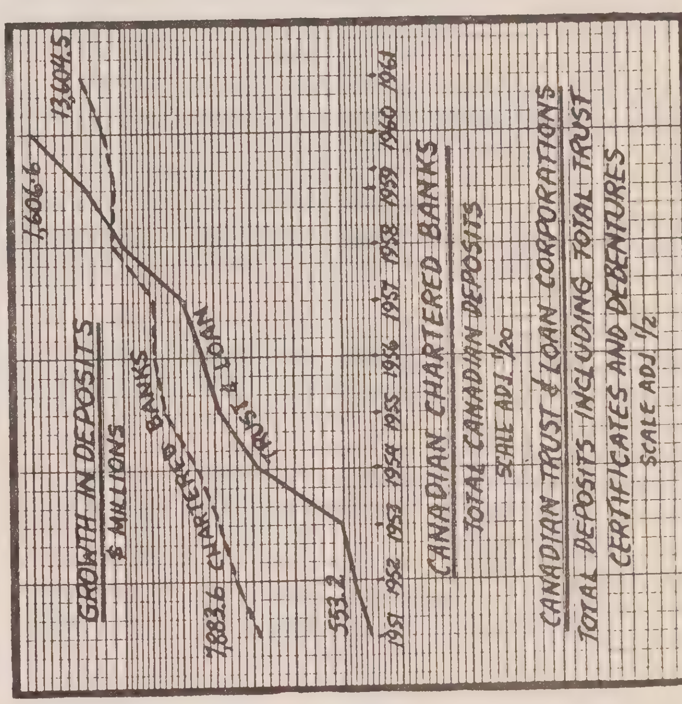
8. To the extent that personal savings were segregated from the commercial lending field, they could be regarded as likewise removed from the category of "money supply". The banks' short-term credit operations would become more responsive to changes in monetary conditions. It would, of course, be the duty of the central bank--as it is today--to see that sufficient money was made available to permit an adequate volume of short-term credit to be provided through the banking system. The volume of short-term loans might not be any different from what it has been, on the average and allowing for normal growth, but a tendency towards excessive expansion in periods of inflationary pressures would be more readily restrained. Fluctuations in mortgage lending would of course be much less pronounced. The workings of monetary policy would become more predictable and more effective. The possibility of a gradual approach towards arrangements of the sort outlined would seem to be worthy of study and discussion. Progress in such an approach would be directed towards expanding mortgage loans and other appropriate investments based on future increases in savings deposits, not reducing the volume of commercial or general loans.

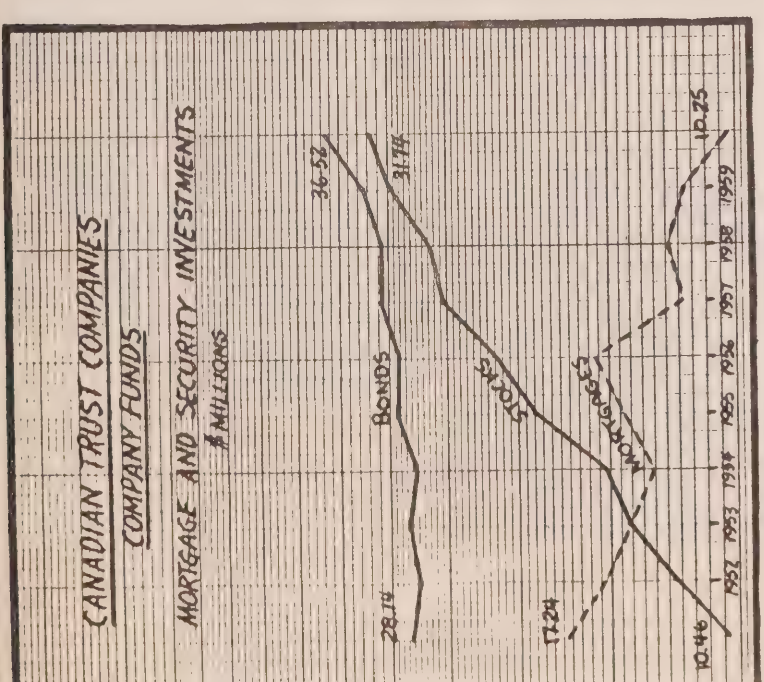
EXHIBIT F


CANADIAN CHARTERED BANKS
(AS AT DECEMBER 31ST)
$ MILLIONS
$ MILLIONS
7,568.9
6,744.2
3,488.2
4,611.5
3,029.7
2,941.3
PERSONAL SAVINGS DEPOSITS
LOANS IN CANADA EXCEPT CALL LOANS
ALL SECURITY HOLDINGS AND MORTGAGES EXCEPT TREASURY BILLS & CANADA'S MATURING UNDER 2 YEARS
1951
1952
1953
1954
1955
1956
1957
1958
1959
1960
1961
(11 MONTHS)


CANADIAN LOAN CORPORATIONS
MORTGAGE AND SECURITY INVESTMENTS
DEPOSITS AND DEBENTURES
$ MILLIONS
MORTGAGES (1)
DEBENTURES (2)
DEPOSITS (2)
BONDS (1)
STOCKS (1)
470.08
362.55
135.40
72.75
25.70
205.61
131.68
86.91
44.36
11.61
(1) ASSETS
(2) LIABILITIES
1951 1952 1953 1954 1955 1956 1957 1958 1959 1960


CANADIAN TRUST COMPANIES
GUARANTEED FUNDS
MORTGAGE AND SECURITY INVESTMENTS
$ MILLIONS
BONDS
MORTGAGES
STOCKS 4.41 1951; 5.31 1960
586.26
412.44
198.84
100.69
1952 1953 1954 1955 1956 1957 1958 1959 1960


GROWTH IN DEPOSITS
$ MILLIONS
CHARTERED BANKS
TRUST & LOAN
7,883.6
553.2
1,606.6
13,004.5
1951 1952 1953 1954 1955 1956 1957 1958 1959 1960 1961
CANADIAN CHARTERED BANKS
TOTAL CANADIAN DEPOSITS
SCALE ADJ. 1/20
CANADIAN TRUST & LOAN CORPORATIONS
TOTAL DEPOSITS INCLUDING TOTAL TRUST
CERTIFICATES AND DEBENTURES
SCALE ADJ. 1/2


CANADIAN TRUST COMPANIES
COMPANY FUNDS
MORTGAGE AND SECURITY INVESTMENTS
$ MILLIONS
BONDS
STOCKS
MORTGAGES
28.14
36.52
31.74
17.24
10.46
10.25
1952 1953 1954 1955 1956 1957 1958 1959

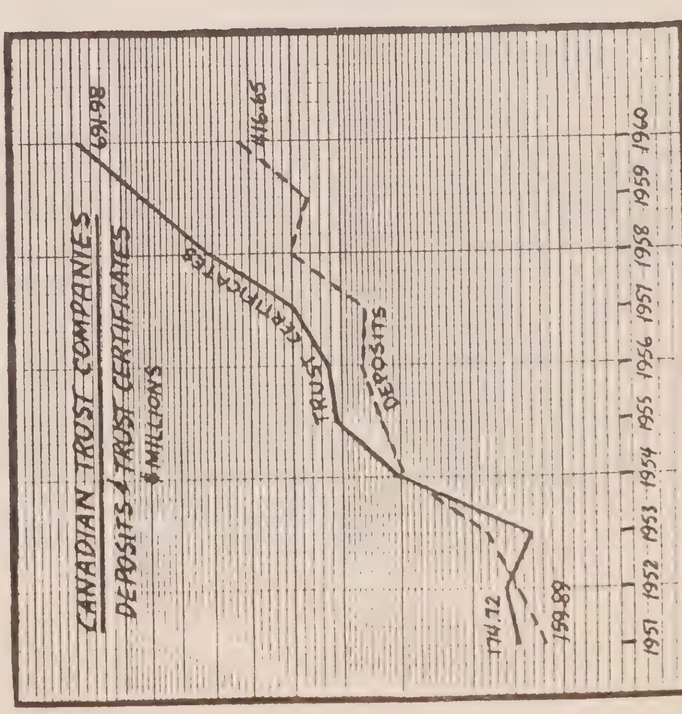

CANADIAN TRUST COMPANIES
DEPOSITS & TRUST CERTIFICATES
$ MILLIONS
TRUST CERTIFICATES
DEPOSITS
691.98
416.65
174.72
159.89
1951 1952 1953 1954 1955 1956 1957 1958 1959 1960

EXHIBIT C
Table 1

CANADIAN TRUST COMPANIES (as at December 31st)

Balance Sheet ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Assets										
Company Funds										
Mortgages	10.25	11.84	12.45	11.93	15.76	14.43	13.14	14.19	15.25	17.24
Securities	68.26	62.15	57.24	56.19	50.50	48.14	43.03	42.70	39.98	38.60
Loans	5.70	6.58	5.70	5.48	5.61	4.97	5.02	4.50	5.28	4.89
Cash	7.66	5.25	6.15	4.11	4.36	4.50	4.95	4.11	3.24	3.17
Other Assets (1)	23.70	23.19	20.69	20.02	18.61	15.75	15.01	13.74	12.95	13.06
Total Assets	115.57	109.01	102.23	97.73	94.84	87.79	81.15	79.24	76.70	76.96
(1) Includes office premises and real estate held for sale.										
Guaranteed Funds										
Mortgages	442.44	381.42	316.57	247.42	238.24	199.45	152.30	123.78	110.89	100.69
Securities	591.57	442.37	411.51	317.74	295.31	322.16	302.25	200.23	203.35	203.25
Loans	45.86	41.60	48.46	33.67	26.42	29.55	26.19	13.93	14.87	15.30
Cash	30.45	34.64	29.69	30.77	37.58	26.20	24.18	18.98	25.94	16.10
Other Assets	—	.15	.08	—	—	—	—	2.48	—	(.04)
Total Assets	1,110.32	900.18	806.31	629.60	597.55	577.36	504.92	359.40	355.05	335.30
Grand Total Assets	1,225.89	1,009.19	908.54	727.33	692.39	665.15	586.07	438.64	431.75	412.26
Estates, Trusts & Agency Funds	7,068.90	6,613.23	6,020.54	5,280.16	4,818.04	4,416.45	4,125.89	3,892.62	3,731.93	3,593.38
Liabilities										
Company Funds										
Equity (2)	100.06	95.34	88.35	84.18	80.89	74.91	67.97	66.78	64.86	64.22
Other Liabilities	15.51	13.67	13.88	13.55	13.95	12.88	13.18	12.46	11.84	12.74
Total Liabilities	115.57	109.01	102.23	97.73	94.84	87.79	81.15	79.24	76.70	76.96
Guaranteed Funds										
Deposits	416.65	337.85	350.42	279.10	281.94	266.80	249.45	191.89	174.33	159.89
Trust Certificates	691.98	561.10	454.90	349.57	314.56	309.86	254.93	166.74	180.08	174.72
Other Liabilities	1.69	1.23	.99	.93	1.05	.70	.54	.77	.64	.69
Total Liabilities	1,110.32	900.18	806.31	629.60	597.55	577.36	504.92	359.40	355.05	335.30
Grand Total Liabilities	1,225.89	1,009.19	908.54	727.33	692.39	665.15	586.07	438.64	431.75	412.26
(2) Includes reserve fund and contingency reserve of: ($ millions)	54.33	49.56	43.34	40.52	38.16	35.41	31.19	28.85	28.30	27.35
Earnings ($ millions)										
Guaranteed Fund										
Revenue										
- mortgages	27.10	21.90	17.22	14.89	13.04	10.25	7.85	6.44	5.61	4.83
- securities (3)	27.89	18.05	14.99	12.30	10.64	10.53	8.93	6.80	6.11	5.60
- loans	2.51	1.86	1.81	1.31	1.19	.92	.68	.54	.73	.58
- other revenue	.30	.15	.15	.23	.13	.27	.16	.09	.09	.08
	57.80	41.96	34.17	28.73	25.00	21.97	17.62	13.87	12.54	11.09
Expenditures										
- interest paid on deposits	11.67	9.82	8.36	7.68	6.03	5.42	4.72	3.38	2.78	2.41
- interest pd. on trust cert.	30.79	19.73	15.08	12.00	9.70	7.81	6.20	4.75	4.42	3.96
- other expenses	.72	.62	.60	.40	1.07	.84	.25	.18	.07	.09
	43.18	30.17	24.04	20.08	16.80	14.07	11.17	8.31	7.27	6.46
Profit on Guaranteed Funds	14.62	11.79	10.13	8.65	8.20	7.90	6.45	5.56	5.27	4.63
Company Fund										
Revenue										
- estates trusts agency fees etc	37.17	35.38	32.55	29.96	27.00	24.20	21.14	19.36	17.90	17.04
- profit in guar. funds	14.62	11.79	10.13	8.65	8.20	7.90	6.45	5.56	5.27	4.63
	51.79	47.17	42.68	38.61	35.20	32.10	27.59	24.92	23.17	21.67
- mortgages	.92	.86	.93	.93	1.00	.78	.82	.84	.95	.91
- securities (3)	3.89	3.62	3.54	2.71	2.80	2.50	2.30	1.89	1.94	2.09
- loans	.50	.47	.37	.40	.39	.36	.30	.36	.26	.27
- other revenue	2.14	1.64	1.59	1.42	1.17	1.00	.97	.84	.75	.73
	7.45	6.59	6.43	5.46	5.36	4.64	4.39	3.93	3.90	4.00
Total Revenue	59.24	53.76	49.11	44.07	40.56	36.74	31.98	28.85	27.07	25.67
(3) Includes net profit or loss on sale of securities.										
Expenditures (4) (5)	43.91	39.98	36.76	33.32	30.36	27.09	23.44	21.59	23.53(6)	22.39(6)
Net Earnings before Taxes	15.33	13.78	12.35	10.75	10.20	9.65	8.54	7.26	3.54	3.28
Less: Income Taxes	7.05	6.12	5.03	4.52	3.99	4.12	3.78	3.09	N.A.	N.A.
Net Profit	8.28	7.66	7.32	6.23	6.21	5.53	4.76	4.17	3.54	3.28
Dividends	5.00	4.50	4.19	3.90	3.55	3.18	2.88	2.79	2.75	2.70
Balance	3.28	3.16	3.13	2.33	2.66	2.35	1.88	1.38	.79	.58
(4) Includes net amounts transferred to investment reserves of: ($ millions)	1.12	.98	1.04	.77	1.14	1.02	.45	.43	.57	1.06
(5) Includes net amounts by which ledger values of assets were written down. ($ millions)	.13	.13	.20	.11	.13	.12	.13	.10	.18	.16

(6) Includes unstated income taxes.

(Composite of 23 Trust Companies)
CANADIAN TRUST COMPANIES

E. & O. E.

Table 2

CANADIAN TRUST COMPANIES (as at December 31st)

Ratios	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Guaranteed Fund % Total Assets	90.57	89.20	88.75	86.56	86.30	86.80	86.15	81.94	82.24	81.33
Guaranteed Fund Mortgages % Total Guar. Fund Assets	39.85	42.37	39.26	39.30	39.87	34.55	30.16	34.44	31.23	30.03
Guaranteed Fund Securities % Total Guaranteed Fund Assets	53.28	49.14	51.04	50.47	49.42	55.80	59.86	55.71	57.27	60.62
Deposits % Guaranteed Funds	37.52	37.53	43.46	44.33	47.18	46.21	49.40	53.39	49.10	47.69
Equity % Guaranteed Fund*	9.01	10.59	10.96	13.37	13.54	12.97	13.46	18.58	18.27	19.15
Company Fund Mortgages % Total Company Fund Assets	8.87	10.86	12.18	12.21	16.62	16.44	16.19	17.91	19.88	22.40
Company Fund Securities % Total Company Fund Assets	59.06	57.01	55.99	57.50	53.25	54.84	53.03	53.89	52.13	50.16
Revenue from Estates, Trusts, etc. % Total under Administration	0.53	0.53	0.54	0.57	0.56	0.55	0.51	0.50	0.48	0.47
Profit in Guaranteed Funds % Total Assets Guar. Fund	1.32	1.31	1.26	1.37	1.37	1.37	1.28	1.55	1.48	1.38
Company Fund Mortgage Rev. % Mortgage Investment	8.98	7.26	7.47	7.80	6.35	5.41	6.24	5.92	6.23	5.28
Company Fund Securities Rev. % Securities Investment	5.70	5.82	6.18	4.82	5.54	5.19	5.35	4.43	4.85	5.41
Company Fund Revenues % Company Fund Assets	6.45	6.05	6.29	5.59	5.65	5.29	5.41	4.96	5.08	5.20
Expenditures % Revenue	74.12	74.37	74.85	75.61	74.85	73.73	73.30	74.84	N.A.	N.A.
Net Profit % Equity	8.28	8.03	5.69	5.37	4.93	7.38	7.00	6.24	5.46	5.11
Dividend % Net Profit	60.39	58.75	57.24	62.60	57.17	57.50	60.50	66.91	77.68	82.32

* Borrowing power on debentures and other securities and by way of deposits, by law, is limited to $12\frac{1}{2}$ times (8%) of Paid-up Capital and Reserve (equity.)

Source: Report of the Registrar of Loan and Trust Corporations for the Province of Ontario. The report includes the particulars of the business of each trust company registered and conducting business in Ontario comprised of the following twenty-three companies in 1960, listed in order of size of total assets, including estates, trusts and agency funds under administration, in $ millions.

1. Royal Trust Co.	2,461.83	
2. Montreal Trust Co.	1,817.03	
3. National Trust Co.	837.80	
4. Toronto General Trusts Corp.	607.85	
5. Canada Trust Co.	491.20	
6. Administration and Trust Co.	301.89	
7. Eastern Trust Co.	254.78	
8. General Trust of Canada	252.03	
9. Guaranty Trust Co.	249.83	
10. Crown Trust Co.	240.08	
11. Canada Permanent Trust Co.	205.91	
12. Chartered Trust Co.	182.48	
13. Waterloo Trust & Savings Co.	110.37	
14. Victoria and Grey Trust Co.	99.33	
15. British Mortgage & Trust Co.	44.72	
16. Sterling Trusts Corp.	35.96	
17. Premier Trust Co.	28.96	
18. Prudential Trust Co.	21.24	
19. Industrial Mortgage & Tr. Co.	20.94	
20. Investors Trust Co.	13.95	
21. Halton & Peel Trust & Sav. Co.	12.35	
22. Lambton Trust Co.	3.83	
23. Bankers' Trust Co.	.43	

E. & O. E.

EXHIBIT G
Table 3

CANADIAN TRUST COMPANIES (as at December 31st)

Assets Invested in Securities ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Company Funds										
- Bonds	36.52	32.21	30.86	30.83	29.12	29.13	27.76	28.26	27.59	28.14
- Stocks	31.74	29.94	26.38	25.36	21.38	19.01	15.27	14.44	12.39	10.46
Total Securities	68.26	62.15	57.24	56.19	50.50	48.14	43.03	42.70	39.98	38.60
Total Co. Fund Assets	115.57	109.01	102.23	97.73	94.84	87.79	81.15	79.24	76.70	76.96
Guaranteed Funds										
- Bonds	586.26	438.17	407.27	314.28	291.57	318.75	299.37	197.75	200.01	198.84
- Stocks	5.31	4.20	4.24	3.46	3.74	3.41	2.88	2.48	3.34	4.41
Total Securities	591.57	442.37	411.51	317.74	295.31	322.16	302.25	200.23	203.35	203.25
Total Guar. Fund Assets	1,110.32	900.18	806.31	629.60	597.55	577.36	504.92	359.40	355.05	335.30
Totals of Both Funds										
- Bonds	622.78	470.38	438.13	345.11	320.69	347.88	327.13	226.01	227.60	226.98
- Stocks	37.05	34.14	30.62	28.82	25.12	22.42	18.15	16.92	15.73	14.87
Total Securities	659.83	504.52	468.75	373.93	345.81	370.30	345.28	242.93	243,33	241.85
Total Assets Both Funds	1,225.89	1,009.19	908.54	727.33	692.39	665.15	586.07	438.64	431.75	412.26
Revenue from Securities (1) ($ millions)										
Company Funds										
- Bonds	1.81	1.55	1.40	1.24	1.17	1.07	1.01	1.01	.95	.99
- Stocks	1.70	1.67	1.39	1.24	1.07	.96	.83	.72	.69	.60
Total	3.51	3.22	2.79	2.48	2.24	2.03	1.84	1.73	1.64	1.59
Guaranteed Funds										
- Bonds	27.52	18.36	14.88	12.49	10.92	10.68	8.40	7.17	6.49	5.94
- Stocks	.11	.11	.18	.15	.16	.18	.15	.15	.18	.20
Total	27.63	18.47	15.06	12.64	11.08	10.86	8.55	7.32	6.67	6.14

(1) Excludes profit (or loss) on sale of securities.

	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Totals of Both Funds										
- Bonds	29.33	19.91	16.28	13.73	12.09	11.75	9.41	8.18	7.44	6.93
- Stocks	1.81	1.78	1.57	1.39	1.23	1.14	.98	.87	.87	.80
Total Revenue	31.14	21.69	17.85	15.12	13.32	12.89	10.39	9.05	8.31	7.73
Ratios										
Company Funds										
Bonds % Co. Fund Assets	31.60	29.55	30.19	31.54	30.70	33.18	34.21	35.66	35.97	36.56
Stocks % Co. Fund Assets	27.46	27.46	25.80	25.94	22.54	21.65	18.82	18.22	16.15	13.59
Guaranteed Funds										
Bonds % Guar. Fund Assets	52.80	48.68	50.51	49.92	48.79	55.21	59.29	55.02	56.33	59.30
Stocks % Guar. Fund Assets	.48	.47	.53	.55	.63	.59	.57	.69	.94	1.32
Bonds % Total Assets Both Funds	50.80	46.61	48.22	47.45	46.32	52.30	55.82	51.53	52.72	55.06
Stocks % Total Assets Both Funds	3.02	3.38	3.37	3.96	3.63	3.37	3.10	3.86	3.64	3.61
Income Yields (2)										
Company Funds										
- Bonds	4.96	4.81	4.54	4.02	4.02	3.67	3.64	3.57	3.44	3.52
- Stocks	5.36	5.58	5.27	4.89	5.00	5.05	5.44	4.99	5.57	5.74
Guaranteed Funds										
- Bonds	4.69	4.19	3.65	3.97	3.75	3.35	2.81	3.63	3.24	2.99
- Stocks	2.07	2.62	4.25	4.34	4.28	5.28	5.21	6.05	5.39	4.54
Yields of Both Funds										
- Bonds	4.71	4.23	3.72	3.98	3.77	3.38	2.88	3.62	3.27	3.05
- Stocks	4.89	5.21	5.13	4.82	4.90	5.08	5.40	5.14	5.53	5.38
Total Securities	4.72	4.30	3.81	4.04	3.85	3.48	3.01	3.73	3.42	3.20

(2) Calculated on 1960 revenues as a percentage of book value of security investments outstanding as at December 31st, 1960 and is, therefore, not a weighted average return on investment.

EXHIBIT G
Table 4

SELECTED CANADIAN TRUST COMPANIES (as at December 31st, 1960)

Assets ($ millions)	Industry (23 cos.)	Chartered Trust	Crown Trust	Eastern Trust	Guaranty Trust	Industrial Mtge & Trust	Montreal Trust	National Trust	Premier Trust	Royal Trust	Victoria & Grey Trust	Waterloo Trust
Company Funds												
- Mortgages	10.25	.02	—	1.05	—	.23	.90	—	.40	1.67	.19	—
- Bonds	36.52	3.15	2.08	1.50	4.37	.34	2.81	1.62	1.14	5.04	.44	1.02
- Stocks	31.74	.98	.93	.76	1.99	.10	4.98	3.55	.11	5.52	3.78	1.83
Total Co. Fund Assets	115.57	5.50	4.17	4.23	8.23	1.42	13.28	7.73	2.06	23.25	5.87	4.40
Guaranteed Funds												
- Mortgages	442.44	22.40	21.60	16.49	45.27	8.84	25.03	43.85	15.07	23.99	43.01	30.31
- Bonds	586.26	21.13	13.03	22.04	43.20	5.67	92.61	64.14	2.79	133.74	27.32	32.54
- Stocks	5.31	—	.06	.36	1.54	.11	—	2.28	—	—	—	—
Total Guar. Fund Assets	1,100.32	44.72	37.04	41.28	94.87	15.15	129.54	112.51	19.66	186.43	71.81	65.76
Grand Total Assets	1,225.89	50.22	41.21	45.51	103.10	16.57	142.82	120.24	21.72	209.68	77.68	70.16
Estates, Trusts & Agency Funds	7,068.90	132.26	198.87	209.27	146.73	4.37	1,674.21	717.56	7.24	2,252.15	21.65	40.21
Liabilities ($ millions)												
Company Funds												
- Equity	100.06	4.51	4.01	3.20	7.51	1.35	11.94	7.19	1.94	16.25	5.19	4.20
Guaranteed Funds												
- Deposits	416.65	26.56	17.95	10.38	47.14	6.78	10.67	97.83	3.07	—	22.42	37.31
- Trust Certificates	691.98	17.80	19.09	30.90	47.73	8.37	118.88	14.68	16.59	186.37	49.37	28.44
Revenue ($ millions)												
Estates, Trusts etc.	37.17	1.86	2.06	1.12	1.42	.02	6.59	4.76	.12	8.98	.10	.29
Profit in Guar. Fund	14.62	.72	.70	.48	1.36	.28	1.20	1.57	.56	1.35	1.33	1.12
Company Funds												
- Mortgages	.92	.01	—	.07	—	.03	.06	—	.04	.10	.01	—
- Bonds (1)	1.81	.14	.10	.05	.22	.01	.09	.07	.03	.33	.04	.06
- Stocks (1)	1.70	.04	.04	.03	.09	.04	.25	.25	.02	.27	.24	.09
(1) Includes net profit or loss on sale of securities.												
Total Revenue	59.24	2.82	3.04	1.76	3.20	.37	8.71	7.17	.81	11.62	1.84	1.72
Expenditures	43.91	2.10	2.43	1.40	1.82	.23	6.57	5.99	.40	8.77	1.04	1.17
Net Earnings before Taxes	15.33	.72	.61	.36	1.38	.14	2.14	1.18	.41	2.85	.80	.55
Income Taxes	7.05	.35	.28	.15	.60	.06	.95	.54	.20	1.33	.33	.26
Net Profit	8.28	.27	.33	.21	.78	.08	1.19	.64	.21	1.52	.47	.29
Dividends	5.00	.18	.15	.14	.28	.07	.69	.57	.10	.96	.34	.18
Ratios												
Co. Mtges. % Co. Fund Assets	8.87	.36	—	24.82	—	16.20	6.77	—	19.42	7.18	3.24	—
Co. Bonds % Co. Fund Assets	31.60	57.27	49.88	35.46	53.10	23.94	21.16	20.96	55.34	21.68	7.50	23.18
Co. Stocks % Co. Fund Assets	27.46	17.82	22.30	17.97	24.18	7.04	37.50	45.92	5.34	23.74	64.40	41.59
Guar. Mtges % Guar. Fund Assets	39.85	50.09	58.32	39.95	47.72	58.35	19.32	38.97	76.65	12.87	59.89	46.09
Guar. Bonds % Guar. Fund Assets	52.80	47.25	35.18	53.39	45.54	37.43	71.49	57.01	14.19	71.74	38.04	49.48
Guar. Fund % Grand Total Assets	90.57	89.05	89.88	90.71	92.02	91.43	90.70	93.57	90.52	88.91	92.44	93.73
Deposits % Guar. Fund	37.53	59.39	48.46	25.15	49.69	44.75	8.23	86.95	15.62	—	31.22	56.74
Trust Certs. % Guar. Fund	62.32	39.80	51.54	74.85	50.31	55.25	91.77	13.05	84.38	99.97	68.75	43.25
Equity % Guar. Fund	9.01	10.08	10.83	7.75	7.92	8.91	9.22	6.39	9.87	8.72	7.23	6.39
Revenue from Estates etc. % Total Under Administration	.53	1.41	1.04	.54	.97	.46	.39	.66	1.66	.40	.46	.72
Profit in Guar. Funds % Total Guar. Fund Assets	1.32	1.61	1.89	1.16	1.43	1.85	.93	1.40	2.85	.72	1.85	1.70
Income Yield on Co. Mtges. (2)	8.98		—	6.67	—	13.04	6.67	—	11.06	5.99	5.26	—
Income Yield on Co. Bonds (2)	4.96	4.44	4.81	3.33	5.03	2.94	3.20	4.32	2.63	6.55	9.09	5.88
Income Yield on Co. Stocks (2)	5.36	4.08	4.30	3.95	4.52	4.65	5.02	7.04	19.98	4.89	6.35	4.92
Revenue (excluding rev. from estates) % Grand Total Assets	1.80	1.91	2.38	1.41	1.73	2.11	1.48	2.00	3.18	1.26	2.24	2.04
Expenditures % Revenue	74.12	74.47	79.93	79.55	56.88	62.16	75.43	83.54	49.38	75.47	56.52	68.02
Net Profit % Grand Total Assets	.68	.74	.80	.46	.76	.48	.83	.53	.97	.72	.61	.41
Net Profit % Equity	8.28	8.20	8.23	6.56	10.39	5.93	9.97	8.90	10.82	9.35	9.06	6.90
Dividend % Net Profit	60.39	48.65	45.45	66.67	35.90	87.50	57.98	89.06	47.62	63.16	72.34	62.07

(2) Calculated on 1960 revenues as a percentage of book value of mortgage and security investments outstanding as at December 31st, 1960 and is, therefore, not a weighted average return on investment.

E. & O. E.

EXHIBIT G
Table 5

CANADIAN LOAN CORPORATIONS (as at December 31st)

Balance Sheet ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Assets										
Mortgages	470.68	415.61	373.05	339.70	325.08	294.03	264.35	236.70	217.96	205.61
Bonds	72.75	62.85	63.89	51.44	43.59	58.10	57.74	40.74	45.47	44.36
Stocks	25.70	25.14	22.25	18.75	18.07	15.87	12.87	11.23	11.69	11.61
Loans	1.42	2.04	.98	.57	3.19	4.14	1.72	2.50	1.83	.70
Cash	9.96	12.60	8.87	9.86	8.38	10.04	9.48	8.70	9.85	13.16
Other Assets	12.50	12.42	11.92	11.54	10.12	8.51	8.60	8.81	8.96	8.54
Total Assets	593.01	530.66	480.96	431.86	408.43	390.69	354.76	308.68	295.76	283.98
Liabilities										
Deposits	135.40	123.43	139.50	120.23	121.44	122.07	107.85	92.65	91.38	86.91
Debentures	362.55	320.21	256.88	233.68	209.75	190.66	175.48	148.72	137.92	131.68
Other	15.83	10.92	7.81	21.83	8.90	26.40	21.66	18.25	18.94	18.37
Liabilities to Public	513.78	454.56	404.19	375.74	340.09	339.13	304.99	259.62	248.24	236.96
Capital Stock	31.99	29.87	30.00	29.00	29.00	28.00	27.75	27.75	27.17	27.27
General Reserve	44.13	42.62	42.92	23.78	36.19	20.67	19.56	18.52	18.12	17.34
Undivided Profit	3.11	3.61	3.85	3.34	3.15	2.89	2.46	2.78	2.23	2.41
Equity	79.23	76.10	76.77	56.12	68.34	51.56	49.77	49.05	47.52	47.02
Total Liabilities	593.01	530.66	480.96	431.86	408.43	390.69	354.76	308.68	295.76	283.98
Earnings ($ millions)										
Revenue										
Mortgages	31.20	27.24	23.89	22.12	19.87	17.52	15.32	13.32	12.05	11.12
Bonds	3.11	2.59	2.34	1.57	1.78	1.98	1.73	1.43	1.49	1.42
Stocks	1.47	1.27	.99	.92	.90	.78	.63	.59	.61	.65
Loans	.15	.10	.06	.02	.02	.03	.01	.01	.01	.01
Other Revenue (1)	2.82	2.60	3.13	1.71	1.53	1.83	1.78	1.61	1.47	1.32
	38.75	33.80	30.41	26.34	24.10	22.14	19.47	16.96	15.63	14.52
(1) Includes net profit (or loss) on sale of securirites and real estate. (dollars)	852,605	349,702	312,964	340,591	213,948	603,927	543,487	136,947	166,266	245,612
Expenditures	29.55	25.04	21.08	17.85	16.22	14.80	13.12	11.09	12.88(2)	11.82(2)
Net Earnings before Taxes	9.20	8.76	9.33	8.49	7.88	7.34	6.35	5.87	N.A.	N.A.
Less: Income Taxes	4.37	4.14	3.71	3.54	3.23	3.20	3.05	2.61	N.A.	N.A.
Net Profit	4.83	4.62	5.62	4.95	4.65	4.14	3.30	3.26	2.75	2.70
Dividends	3.83	3.65	3.43	3.19	3.03	2.71	2.53	2.33	2.15	2.12
Balance	1.00	.97	2.19	1.76	1.62	1.43	.77	.93	.60	.58

(2) Includes unstated income taxes.

Ratios	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Mortgages % Total Assets	79.37	78.32	77.56	78.66	79.59	75.26	74.52	76.68	73.69	72.40
Bonds % Total Assets	12.27	11.84	13.28	11.91	10.67	14.87	16.28	13.20	15.37	15.62
Stocks % Total Assets	4.33	4.74	4.63	4.34	4.42	4.06	3.63	3.64	3.95	4.09
Deposits % Liabilities to Public	26.35	27.15	34.51	32.00	35.71	35.99	35.36	35.69	36.81	36.68
Debentures % Liab. to Public	70.57	70.44	63.55	62.19	61.67	56.22	57.54	57.28	55.56	55.57
Equity % Liabilities to Public	15.42	16.74	18.99	14.94	20.09	15.20	16.32	18.89	19.14	19.84
Average rate earned on:										
- mortgages (3)	6.63	6.55	6.40	6.51	6.11	5.96	5.80	5.63	5.53	5.41
- bonds (3)	4.27	4.12	3.66	3.05	4.08	3.41	3.00	3.51	3.28	3.20
- stocks (3)	5.72	5.05	4.45	4.91	4.98	4.91	4.90	5.25	5.22	5.60
Revenue % Total Assets	6.53	6.37	6.32	6.10	5.90	5.67	5.49	5.49	5.28	5.11
Expenditures % Revenue	76.26	74.08	69.32	67.77	67.30	66.85	67.39	65.39	N.A.	N.A.
Net Profit % Total Assets	.81	.87	1.17	1.15	1.14	1.06	.93	1.06	.93	.95
Net Profit % Equity	6.10	6.07	7.32	8.82	6.80	8.03	6.63	6.65	5.79	5.74
Dividends % Net Profit	79.30	79.00	61.03	64.44	65.16	65.46	76.67	71.47	78.18	78.52

(3) Calculated on 1960 revenues as a percentage of book value of mortgage and security investments outstanding as at December 31st, 1960, and is, therefore, not a weighted average return on investment.

Source: Report of the Registrar of Loan and Trust Corporations for the Province of Ontario. The report includes the particulars of the business of each loan company registered and conducting business in Ontario comprised of the following nine companies in 1960, listed in order of size of total assets in $ millions.

1. Canada Permanent Mortgage Corp.	233.39	4. Eastern Canada Savings and Loan Co.	46.17	7. Royal Trust Company Mortgage Corp.	2.55
2. Huron and Erie Mortgage Corp.	152.91	5. Ontario Loan and Debenture Co.	44.55	8. Commonwealth Mortgage & Savings Corp.	.90
3. Credit Foncier Franco-Canadien	100.25	6. Lambton Loan and Investment Co.	11.73	9. Family Mortgage Co.	.57

CANADIAN LOAN CORPORATIONS

E. & O. E.

EXHIBIT G
Table 6

SELECTED CANADIAN LOAN CORPORATIONS (as at December 31st, 1960)

	Industry (9 Cos.)	Canada Permanent Mtge.	Credit Foncier Franco-Canadien	Eastern Can. Savings & Loan	Huron & Erie Mortgage	Lambton Loan & Investment	Ontario Loan & Debenture
Assets ($ millions)							
Mortgages	470.68	181.08	81.67	41.06	117.45	9.51	36.04
Bonds	72.75	30.79	7.21	3.77	22.31	1.20	7.46
Stocks	25.70	9.98	7.30	.58	7.07	.33	.44
Total Assets	593.01	233.39	100.25	46.17	152.91	11.73	44.55
Liabilities ($ millions)							
Deposits	135.40	64.51	—	6.58	52.32	3.27	8.67
Debentures	362.55	145.86	57.12	34.95	88.18	6.39	29.26
Total Liabilities to Public	513.78	214.62	66.57	42.56	141.05	9.78	38.22
Equity	79.23	18.77	33.68	3.60	11.85	1.95	6.33
Revenue ($ millions)							
Mortgages	31.20	12.16	5.60	2.76	7.42	.61	2.47
Bonds	3.11	1.43	.01	.24	1.08	.0½	.29
Stocks	1.47	.68	.34	.03	.38	.02	.03
Total Revenue	38.75	15.06	7.19	3.06	9.64	.69	2.90
Expenditures	29.55	12.08	4.58	2.44	7.85	.47	2.02
Net Earnings before Taxes	9.20	2.98	2.61	.62	1.79	.22	.88
Income Taxes	4.37	1.37	1.35	.30	.83	.10	.38
Net Profit	4.83	1.61	1.26	.32	.96	.12	.50
Dividends	3.83	1.60	1.06	.19	.57	.11	.30
Ratios							
Mortgages % Total Assets	79.37	77.59	81.47	88.93	76.81	81.07	80.90
Bonds % Total Assets	12.27	13.19	7.19	8.17	14.59	10.23	16.75
Stocks % Total Assets	4.33	4.28	7.28	1.41	6.02	3.47	.99
Deposits % Liabilities to Public	26.35	30.06	—	15.46	37.09	33.44	22.68
Debentures % Liab. to Public	70.57	67.96	85.80	82.12	62.52	65.34	76.56
Equity % Liab. to Public	15.42	8.75	50.59	8.46	8.40	19.94	16.56
Average rate earned on:							
- mortgages (1)	6.63	6.72	6.86	6.72	6.32	6.41	6.85
- bonds (1)	4.27	4.64		6.37	4.84	4.36	3.89
- stocks (1)	5.72	6.81	4.66	5.17	5.37	6.06	6.82
Revenue % Total Assets	6.53	6.45	7.17	6.63	6.30	5.88	6.51
Expenditures % Revenue	76.26	80.21	63.70	79.74	81.43	68.12	69.66
Net Profit % Total Assets	.81	.69	1.26	.69	.63	1.02	1.12
Net Profit % Equity	6.10	8.58	3.74	8.89	8.10	6.15	7.90
Dividends % Net Profit	79.30	99.38	84.13	59.38	59.38	91.67	60.00

(1) Calculated on 1960 revenues as a percentage of book value of mortgage and security investments outstanding as at December 31st, 1960, and is, therefore, not a weighted average return on investment.

E. & O. E.

EXHIBIT H

CREDIT UNIONS (1) (as at December 31)

Balance Sheet ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Assets										
- Loans (2)	425	397	320	258	226	174	151	129	94	76
- Mortgages (2)	387	341	295	262	236	211	171	155	131	113
- Investments	279	257	238	200	183	163	144	133	120	100
- Cash	166	129	127	108	94	87	71	51	56	51
- Other Assets	42	34	29	24	22	18	15	21	23	19
- Total Assets	1,299	1,158	1,009	852	761	653	552	489	424	359
Liabilities										
- Shares	474	402	341	272	232	194	161	133	102	81
- Deposits	721	658	594	515	468	409	350	320	294	253
- Other Liabilities	27	29	18	18	16	11	15	27	8	7
- Surplus Funds	77	69	56	47	45	39	26	9	20	18
- Total Liabilities	1,299	1,158	1,009	852	761	653	552	489	424	359
Number of Credit Unions	4,667	4,570	4,485	4,349	4,258	4,100	3,920	3,606	3,333	3,121
Number of Members (thousands)	2,544	2,360	2,187	2,060	1,870	1,731	1,561	1,434	1,260	1,138

(1) Includes Caisse Populaires and, Newfoundland Credit Unions from 1951-58.
(2) For 1951-55 the division of total loans between mortgage loans and other loans has been estimated.

Source: Bank of Canada Statistical Summary.

EXHIBIT I

QUEBEC SAVINGS BANKS (as at December 31st)

Balance Sheet ($ millions)	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951
Assets										
Bank of Canada notes plus deposits with Bank of Canada and Chartered Banks.	25.6	26.4	24.7	26.3	20.3	18.5	19.5	14.7	13.6	16.7
Canadian Securities										
- Government of Canada	38.7	28.2	28.2	38.8	44.9	54.9	64.7	91.6	95.5	89.6
- Provincial	86.7	89.7	102.1	85.6	83.2	80.0	68.0	49.0	48.1	48.6
- Municipal	40.7	46.5	53.3	52.2	56.0	56.7	46.9	37.3	33.1	27.8
- Other	25.2	21.2	18.1	16.8	15.4	16.2	15.6	10.5	8.1	9.2
- Total	191.3	185.6	201.7	193.4	199.5	207.8	195.2	188.4	184.8	175.2
Mortgages and Loans										
- Insured N.H.A. Mortgages	10.4	10.7	10.7	10.1	9.2	5.6	2.7	-	-	-
- Other Mortgages	50.6	47.1	40.0	30.7	20.4	14.1	10.0	6.7	4.4	1.7
- Loans Otherwise Secured	8.0	7.1	6.5	8.8	7.8	5.9	5.0	4.6	4.4	4.3
- Unsecured loans	6.4	6.2	5.6	4.0	3.2	2.3	2.4	3.0	1.7	0.5
- Total	75.4	71.1	62.8	53.6	40.6	27.9	20.1	14.3	10.5	6.5
Other Assets	19.1	14.9	13.7	12.4	12.3	10.9	8.1	8.5	9.2	6.7
Total Assets	311.4	298.0	302.9	285.7	272.7	265.1	242.9	225.9	218.1	205.1
Liabilities										
Secured Advances from										
- Bank of Canada	-	-	-	-	-	-	-	-	-	-
- Chartered Banks	1.6	2.0	4.1	4.7	7.7	5.3	3.0	2.5	1.9	0.8
Deposits										
- Government of Canada	5.6	12.2	6.7	9.9	0.3	0.4	0.3	0.3	-	0.1
- Provincial Government	3.8	2.1	4.1	2.8	0.9	0.1	0.1	0.1	0.1	0.1
- Public	285.3	267.7	274.1	255.1	251.1	246.8	227.4	211.8	205.2	193.3
- Total	294.7	282.0	284.9	267.8	252.3	247.3	227.8	212.2	205.3	193.5
Other Liabilities	1.4	0.7	1.0	0.7	0.5	0.6	0.5	0.3	0.2	0.3
Shareholders Equity	13.7	13.3	12.9	12.5	12.2	11.9	11.6	10.9	10.7	10.5
Total	311.4	298.0	302.9	285.7	272.7	265.1	242.9	225.9	218.1	205.1

Source: Bank of Canada Statistical Summary.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX I

RETAILING BONDS & STOCKS

and

RISK CAPITAL

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX I

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RETAILING BONDS & STOCKS

1. Description of the Retail Market

(1) The retail investor, for the purpose of this submission, is taken as an individual who invests in securities. We believe that a better understanding of this market can be obtained if we describe retail investors in three categories. The actual limits established here should be understood in approximate terms only, as a general guide. We felt some actual figures would have to be stated in defining the categories, and they should therefore be used with the limitations they obviously possess.

I The small investor--an individual with up to approximately $10,000 capital invested in securities.

II The medium investor--an individual with roughly $10,000 to $100,000 capital invested in securities.

III The large investor--the individual who has $100,000 or more capital invested in securities.

(2) Until World War I, Canadian savings were small in volume and were invested chiefly in real estate and real estate mortgages or left on deposit with banks. The banks used most of their assets to make commercial loans, investing only a small portion in securities. Under circumstances such as these no capital market is likely to exist.

(3) Although the Canadian Bond business started in the 1880's when some of our member firms now engaged in the underwriting and distributing of securities were founded, almost all Canadian financing was done in Great Britain until 1914. English bond houses dominated the market and Canadian dealers in most cases acted merely as agents. After receiving the advice of a Canadian dealer, the English bond firm would negotiate directly with the borrower and underwrite the loan, assuming all liability.

(4) Throughout this period the Canadian dealers developed their retail business, confining their activities largely to government and municipal bonds. Methods of buying were rather elementary--the Dealer frequently combed local newspapers for notices of municipalities and then contacted the local authorities with a view to purchasing the entire issue for retail sale. With the tremendous expansion in business which came in the 1900 - 1913 period, Canadian bond houses were able to extend their operations to include a few issues of companies engaged in public utility operation, manufacturing and transportation.

(5) Bond sales had up to the first world war (1914 - 1918) been confined to financial institutions and to wealthy individuals. However, the great increase in wealth in Canada prior to and during World War I made possible the success of the first Victory Loans which require a large number of small purchases. Victory Loan campaigns were organized to make the population "bond conscious" and to persuade the people to loan their savings to the nation. These campaigns, aided by the high interest rates, 5% and 5 1/2%, brought remarkable success.

(6) In 1915, 24,862 persons subscribed for $78,729,000 of the first domestic War Loan issue. In 1918, over one million persons subscribed over $660,000,000 to the Victory Loan of that year. The campaigns were organized at the Government's request, by the newly-formed "Bond Dealers' Association of Canada."

(7) During the period 1920-1930, almost $6 billion was invested in capital goods, but, contrary to earlier periods of expansion, the amount of foreign capital which came in was much smaller. Less than $1 billion of the $6 billion came from the United States. The investment boom of the twenties was very largely financed out of Canadian savings. As a result Canadian financial houses benefitted greatly by the opportunities which presented themselves during this period.

(8) As in World War I, so in World War II, vast sums of money were raised internally by the Dominion Government through the organized sale of Victory Bonds. Almost the entire amount of Canada's war financing was carried out through domestic operations. In eleven war loan operations the Dominion Government borrowed some $12,200 million from its citizens.

(9) A National War Finance Committee, almost wholly composed of investment dealers, was formed with headquarters in Ottawa and offices in each province. This committee acted as the coordinating body for the efforts of all financial firms in Canada and was the driving force behind the raising of funds for the Government through the sale of Victory Loan Bonds and War Savings Certificates.

(10) The wide acceptance of Victory Bonds stemmed from the committee's efforts in educating a large selling force of qualified representatives. The concept of a payroll savings plan was introduced to many employers and its continued use today is evidence of its value.

(11) The Victory Loan campaigns of World War II were responsible for hundreds of thousands of Canadians owning, for the first time, an investment security. Today, there are over two million individual Canadians who own Government of Canada bonds. There is no doubt that these securities, held by such a large percentage of the citizens of the country, are a stabilizing and a supporting factor in the period of postwar readjustment through which we are still passing. The habit of thrift which was encouraged during War Loan years and which is renewed each year in the Canada Savings Bond campaigns, has developed many new investors and provides the basis on which a greater investment business can be built in the years ahead.

The Understanding which the Retail Investor has of Securities Markets

(12) THE SMALL INVESTOR will normally not have a very good knowledge of securities markets. It has been found that he will often have his money invested in either of two extremes, i. e. exceedingly conservative, where capital will be entirely in fixed income, high grade bonds, or extremely speculative, with all funds invested in penny gambling stocks. Of course, the size of his holdings severly restricts the degree of diversification which is possible and in some cases in recent years, the small investor has turned to mutual funds, not necessarily of his own initiative. Very rarely will the small investor be found who owns one or two good investment grade stocks. The small investor depends almost entirely upon his investment dealer, stock broker or bank manager for guidance with his investments, and the investment dealer actually goes out and cultivates this business and does extensive work in guiding and educating the small investor.

(13) THE MEDIUM INVESTOR quite often has a growing account, being an advancing professional or business man whose income is such that substantial yearly savings are possible. Where this is the case, he will often be relatively well informed, though too busy to enter very fully into a study of investments, or to follow the regular progress of his securities. He too, will rely heavily upon his investment dealer or stock broker and will follow his guidance in most matters.

(14) The medium investor could also be someone dependent upon this capital as a supplementary or even sole source of income. This may be a retired, or semi-retired person, a widow or dependent child who has inherited the capital. Generally speaking, this medium investor will not be too sophisticated or knowledgeable in investment matters,

and will tend to follow the guidance of an investment dealer or stock broker. Much of the educational effort done by individual dealers and the Investment Dealers' Association is aimed at this market.

(15) THE LARGE INVESTOR is quite different from the small and medium investor. He will normally be quite well informed on securities and markets, will follow details of prices and know what is going on from day to day. He will read financial journals and periodicals, he may subscribe to one or more investment counsel services and will likely do business with more than one investment dealer or stock broker. This is a more competitive market for the investment dealer, but it is also one where the educational effort does not need to be so great and where the costs of doing business relative to the returns are less.

The Variety of Securities Sold in the Retail Market

(16) The small investor is a market for bonds of all types. In the Province of Quebec, and to some extent in the Maritimes, the small investor is a good market for municipal bonds, but this does not hold true to the same extent in the other provinces. In practice, in the past, the small investor has not constituted a good source of capital for new sound enterprises, though many have gone to outright speculation. There is no reason why this should be so, but it does show that a large job of education is still required, which, of course, immensely increases the costs of doing business.

(17) The medium investor also is a good market for all types of bonds, for good quality common stocks and for serious new ventures. Quite often the medium investor is in a high tax bracket, and is therefore interested in capital appreciation with income a secondary feature.

(18) The large investor provides a good market for all types of securities from short term Government of Canada bonds to common stock in a risk venture.

2. Servicing the Retail Market

The Investment Dealers

(19) In another section of this brief, it is shown that a large percentage of the investment dealers in Canada are in the retail field.

(20) There are as well other financial intermediaries in this field--banks and stock brokers sell securities to the retail market, and some mutual funds have their own sales forces. The banks do not send salesmen into the field as investment dealers do, nor do stock brokers to any large extent. Almost exclusively it is investment dealers who have salesmen travelling and covering territories and carrying a broad variety of securities.

Organization Required to Service Retail Accounts

(21) In order to service retail accounts, the investment dealer must first have the knowledge and resources to select and buy the securities which are to be offered to his clients. He then must have a system of distribution--a sales force with enough clients to purchase the merchandise he has to offer.

(22) Developing a marketing organization is a major task for an investment dealer. To competently service retail accounts investment dealers must have salesmen qualified in the sense that they must be familiar with investments, know how to assess securities and, at the same time, be able to convey this to the ordinary individual. This means the investment dealer must have facilities to train salesmen, and have sufficient resources to carry salesmen until they become productive. In turn, the salesmen must develop a clientele, and

cover a sufficient number of investors so that a wide variety of securities can be sold. He must have enough customers in each category.

(23) The investment dealers must also have an analytical or research department to supply salesmen with information and guidance. The size of this department will depend on the size of the firm and the number of salesmen in the field. Many refinements to research, such as portfolio supervision, have been added in recent years and the competition increasingly demands this type of service.

(24) For investment dealers engaged in underwriting, an underwriting department is required or such work may be the chief function of the senior personnel.

(25) An accounting department and a trading department must be maintained, and the latter particularly requires well trained personnel.

(26) The investment dealer must have a communication system which puts his head office in touch with out of town salesmen and branches. Larger dealers generally use direct wires and all dealers make extensive use of long distance telephone. The business necessitates rapid communication.

(27) This organization will vary with size, but in general it must be said the investment dealer requires sufficient facilities to buy and sell securities, to offer these to his customers, and to provide those customers with sufficient information and guidance on their investments.

(28) It is quite apparent from the foregoing section that the costs of doing retail business are high.

The Supply of Information

(29) A large percentage of the costs of the Investment Dealers' Association goes to service the retail investor, to educate him and to provide him with instructive information. All dealers participate in these association endeavours to educate the general public in two ways. First, a substantial portion of the regular fees go to educational work, and secondly, investment dealers lend personnel who donate their time freely to association endeavours.

(30) Investment dealers must, on an independent basis, make available a broad variety of informative material to the public. This could take the form of a monthly letter discussing general conditions or specific securities, it could be a weekly comment, or a review of a company or a special write-up on a new underwriting.

(31) To prepare this material, investment dealers have research departments which may vary in size from one man for a small or local dealer to possibly a dozen people for a large national dealer. The information itself may vary from a brief comment for general distribution to a 30 or 40 page study for select distribution.

(32) Investment dealers are continually attempting to interest new investors.

(33) Possibly the greatest number of new investors come to an investment dealer from referrels by his existing clientele. In addition, new investors are attracted by advertising, in which some monthly or other type of informative material might be offered. When investors respond, they are followed up by the firm's salesmen.

(34A) New investors can also be approached directly when Government Bonds are being offered, and this is widely done on Canada Savings Bond campaigns. It should be pointed out that investment dealers go out and aggressively sell Canada Savings Bonds to established and new accounts. They do not just accept unsolicited orders. This is considered to be a valuable service since it puts Canada Savings Bonds into the hands of many people who would not otherwise own them, and provides a broader and a stronger distribution of these securities.

(34B) It should be noted that investment dealers are prohibited by law from directly approaching new accounts at home for other than Government Bonds, and this does have a restricting influence on the development of new accounts.

The Training of Retail Salesmen

(35) Investment dealers have sales training programs. In most cases, this necessitates the prospective salesman spending time in each of the different operating departments so that he can become thoroughly familiar with the total operation. During this time, he attends sales meetings and is expected to familiarize himself with investments and securities markets. He is often required to complete one or both of the two courses in the "principles and practices of investment finance in Canada" offered by the Investment Dealers' Association.

(36) Training is, of course, a continuous process of education. The salesman should be able to rely upon his firm for basic information and opinions on conditions in general and securities in particular.

Protecting Investors' Capital

(37) Investment dealers continue to take an interest in an enterprise after the securities of that enterprise have been distributed by them to investors. A representative will often sit on the Board of Directors and even on the management committee and financial statements and reports are obtained and studied regularly. If a situation develops where investors' capital may be in danger, investment dealers will devote a considerable amount of time and, sometimes, capital, to protect their clients' capital and to attempt to restore the enterprise to a profitable operation.

RISK CAPITAL

(38) It is quite apparent and an accepted fact that risk capital is essential to the future development of this country.

Definition

(39) Risk capital, for the purposes of this submission, is taken to mean capital which is used for the development of new ventures, which ventures might be in primary or secondary industry. All types and variations of securities are used to raise risk capital in the retail markets. Bonds and debentures, convertible or with warrants attached, preferred stocks and common stocks are all employed, singly and in units.

Sources of Risk Capital

(40) The risk capital required in Canada has been and will continue to come from corporations, from institutions, from foreign investors and from small groups of large investors and from the general public. It is with this latter group that this submission is concerned.

The Public's Record and Attitude

(41) For purposes of this presentation, we should like to make a distinction between two different types of risk capital.

(a) That capital which is placed for long term investment in ventures, intelligently and seriously conceived and backed by reputable entrepreneurs. This is primarily the business of investment dealers.

(b) That capital which is invested for large, immediate profits, with little or no concern for the ultimate outcome of the enterprise. The degree of risk in this case is extremely high and the chance of ultimate success is often doubtful. Such capital is quite often associated with mining and oil development,

and in some cases, it is difficult to determine the integrity of the scheme.

(42) It is our considered opinion that interest has been developing in that type of capital described under (a), but too many retail investors who do take an interest in (a) will often exploit an early opportunity for small short term capital gain and ignore the ultimate benefits. Thus, the equity in many long term ventures has shifted gradually from the public to institutional and foreign investors, who are more sophisticated and prepared to wait for long term development.

(43) The public will invest and hold the equity of established and proven enterprises for long periods of time, as witness the large retail interest in the common stock of leading Canadian companies, but investing in new unproven enterprise seems to be regarded more as a speculation than a serious and eventually profitable business. The lack of interest in the ultimate development of the actual enterprise itself takes second place to the interest in the short term action of the common stock. Possibly only bitter experience with (b) will eventually change this attitude. The investment dealer, through a widespread educational effort is doing a great deal to help, but it is our considered opinion that this is a long slow process.

Raising Risk Capital

(44) This submission is concerned only with risk capital raised by investment dealers.

(45) Ventures requiring capital may be brought to an investment dealer by a promoter or entrepreneur, who has either previously done business with him, or who has been recommended by someone who has. The investment dealer will study all the facts and thoroughly examine the situation.

(46) Once the investment dealer is satisfied that an enterprise is feasible, he will discuss and suggest what form the financing should take. This latter consideration is affected by many things, including the current markets. Here, of course, government policy is most important in setting the proper environment, and this is true whether fixed income, senior security financing or equity financing is involved.

(47) After this has been done, the securities must be sold. In the retailing operation, the investment dealer will inform his salesman of the details of the proposed issue of securities. How this communication of information actually occurs will vary, but normally the dealer will hold a sales meeting into which he will bring all his salesmen. At this meeting, he will have company representatives to answer questions and fully explain the particular issue. A field trip to the Company's plant or proposed plant or property may take place. The dealer will follow this up with an informative bulletin and, of course, there must be a prospectus.

(48) Once he has a good understanding of the situation, the salesman can then select those of his accounts to which the security is suitable. He can then go to these accounts and sell this security.

(49) In some cases, investors are sold issues they should not really own, by salesmen who, in their desire to make a sale, overlook the circumstances of the case. This is something which investment dealers are continually striving to overcome.

RETAILING BONDS AND STOCKS, AND RISK CAPITAL, CONCLUSIONS AND RECOMMENDATIONS FOR THE I.D.A. BRIEF

References	
Pr. 11, page 3 Pr. 18, page 6	(a) Government of Canada Financing We recommend that greater consideration be given to the retail market when deciding terms of Government of Canada bond issues. Since 1959 - 1960 when various 5 1/2% Bonds were issued, few issues of the Government of Canada have been suitable for retail accounts. From time to time bond issues tailored to the retail market would be most appropriate. For instance, the retail holders of medium term bonds should be given the privilege of converting them into longer term bonds. If this is not done, the probability is that when the medium term bonds become short term bonds, the retail holders will dispose of them because of their low yield and will no longer hold them when new issues of long term securities are offered.
Pr. 46, page 12	(b) Government Influence on Stability Government policies have an immense effect on retail investors. Investment dealers who sell and trade Government and corporation securities and raise risk capital must do so under stable market conditions. Therefore, when disturbing factors arise, Government leaders should do everything possible to clarify the situation and restore stability.
Pr.17, page 5	(c) Tax Credits. It is recommended that the percentage tax credit on dividends which shareholders are now allowed be raised for lower income groups; perhaps the first $500 of annual dividend income would carry a higher percentage of tax credits or even be tax free.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX J

STOCK BUSINESS

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX J

STOCK BUSINESS

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APPENDIX J

STOCK BUSINESS

1. INTRODUCTION In considering the operations of investment dealers, stock business obviously bulks very large and may indeed lay claim to pride of place. In the following pages, an effort is made to describe the nature of this business. It is first intended to examine briefly the various markets where Canadian securities are traded, and this will include a discussion of secondary distributions and the over-the-counter market. Most of the analysis will be concerned with the questions of the supply of and the demand for Canadian stocks. In this connection, some estimates will be made of net annual flows of funds from various sources into the Canadian stock market as well as of the existing importance of selected investors - both individual and institutional - in Canadian equity ownership. In addition, the part played by investment dealers and companies in helping to broaden stock ownership in Canada will be discussed briefly. The section will conclude with a number of recommendations.

2. THE STOCK EXCHANGES IN CANADA There are at present six exchanges in Canada. The relative size of their operations is indicated in the following table, which covers trading in 1960. As a basis of comparison, in the same year the number and value of shares traded on the New York Stock Exchange amounted to 987 million shares and $38.0 billion respectively, and on the American Stock Exchange to 32 million shares and $4.2 billion.

TABLE I

Stock Exchange Transactions in 1960

	Industrial Shares (a)	Mines and Oils Shares	Total Shares	Clearing Values
	- - - - thousand shares		- - - - -	($ thousands)
Toronto	43,758	425,933	469,692	$1,223,330
Montreal (b)	19,298	58,186	77,485	671,993
Vancouver	2,237	19,026	21,263	40,468
Calgary	196	9,812	10,009	2,760
Winnipeg	111	377	488	1,615

(a) Shares of industrials, public utilities, banks, etc.

(b) Montreal Stock Exchange and Canadian Stock Exchange combined.

Source: Toronto Stock Exchange.

3. At the end of 1961 there were 1,117 stocks listed on the Toronto Stock Exchange with a quoted market value of $61 billion, and 832 on the Montreal and Canadian Exchanges with a market value of $59 billion. If account is taken of the substantial amount of duplication arising out of interlistings, the quoted market value of stocks on the Montreal and Toronto exchanges may be estimated at under $62 billion, covering some 1,250 stocks. Of these, 21 with a market value of $31¾ billion consisted of foreign firms, mainly a few large U.S. companies, whose stocks are listed in Canada as well as in the United States. Of the remainder, 168 with a market value of about $1 billion were preferred stocks; this left listings having a value of $29 billion made up of Canadian common, "A" and "B" stocks.

4. A number of Canadian shares are listed abroad, mainly in the United States. At the end of 1961, there were 11 Canadian companies listed on the New York Stock Exchange and 94 on the American Stock Exchange. Other centers where Canadian stocks are traded include London, Brussels and Paris.

5. As a measure of trading activity, Toronto clearing values in 1961 represented 4.1% of the total quoted market value of the list at the end of the year. If the foreign stocks are

excluded, the proportion is raised to 8.6%. A further refinement is the removal of that section of the list which is in effect untradeable; this includes stocks that are owned on a permanent basis, notably inter-company holdings. The Bank of Nova Scotia, in its monthly review of October 1960, estimates that 30% of Canadian securities fall into this class, which would reduce the market value at the close of 1961 of potentially active stocks on the Toronto list to $20.5 billion and lift the measure of trading activity (clearing values of that year as a proportion of the adjusted total) to 12.3%. It should be noted that 1961 was an active period in stock trading; in 1960, on the other hand, which was slow, clearing values were only half as large.

Secondary Distributions

6. In any discussion of the operations of Canadian stock markets, the secondary method of distribution must be mentioned. Usually, the offering is of a block of stock which is too big to be readily assimilated in the day-to-day market on the stock exchanges. In Canada, the total value of the stock offered in any one distribution might range between $250,000 to perhaps $2 million or $3 million. These "secondaries", developed several years ago, have been used more and more frequently in the past two or three years as the most efficient method of distributing stocks on a wide basis.

7. The vendor of the stock, by negotiation with one dealer, will agree to terms of offering, such as pricing and the commission to be paid to the underwriting or distributing group. The originating dealer usually invites other dealers to accept an underwriting position in the group. This group accepts firm stock at the offering price, less a commission previously arranged.

8. The price at which the offering will be made usually bears a very close relationship to the quoted market on the Stock

Exchange for the stock. Generally speaking, the offering price is on the bid side of the market or, in some cases, slightly below the bid side. Various factors must be considered when pricing the offering, such as general market conditions, outlook for the company whose stock is being offered, and the popularity of the stock being offered.

9. The commission paid on the offering, as it has developed in the Canadian market, usually amounts to double the minimum Stock Exchange commission on a stock selling at the offering price and, in some cases, there may be an additional small commission which might be considered a finder's fee. It might be noted that commissions paid on secondary distributions in the U.S. market range from about four to six and a half times the average minimum commission rate.

Stock Exchange Commissions in Canada

10. Since the late 1930's there have been two revisions of the scale of commissions charged by brokers for effecting transactions for their clients. The first realignment in 1945 involved almost entirely an upward revision of charges in all classes. The second was a combination of upward revisions and reclassifications which removed certain anomalies in the fees charged to clients. In themselves, the upward adjustments were not substantial in relation to the volume of money involved in many transactions. It should be noted that, in the post-war period, demands for added services, communications and servicing of transactions have required a considerable increase in operating expenditures by brokers. A further revision of these brokerage charges may have to be made so as to reflect more fully the dollar value of the transaction and the true cost of effecting the smaller transactions. In other words, commissions may have to be re-examined in the light of operating expenditures on services, the maintenance of which is necessary if the full interests of clients are to be served. This would be done only after a thorough and exhaustive review of the

increased capital cost of doing business and of the relationship of commissions to the dollar value of the transaction.

The Over-the-Counter Market

11. The Canadian over-the-counter market covers virtually all transactions of the following securities: Government, Provincial and Municipal bonds and corporate debentures; in addition, many stock issues, which for one reason or another are not listed on an exchange, are traded on the market, as well as most mutual fund shares. Among the quality stocks involved, mention may be made of those of a number of insurance companies and trust companies. Transactions also take place in several European securities, particularly of British origin. The over-the-counter market is extensively used by investment dealers,providing an initial market for new issue securities. Most new industrial issues, being offered for the first time to the Canadian public, initially trade over the counter prior to becoming listed on recognized Canadian stock exchanges. Rights offerings to shareholders in a good many cases trade over the counter during a limited period until the right expires.

12. In the natural resource field, the over-the-counter market facilitates trading in a wide variety of low-priced speculative securities. These stocks usually represent small exploration attempts to develop natural resources in Canada. Usually, where success is achieved in the development of a natural resource, the stock in question will qualify for listing on one of the stock exchanges in the country; the vast majority of these speculative vehicles, however, remains unlisted and very often dormant until revived by circumstances within their area of activity.

13. The over-the-counter market is vast and complex and not located in any given meeting place. From coast to coast, traders in investment and brokerage firms are constantly in

touch with each other through private telegraph wires, telephones and other communication facilities at their disposal. In the over-the-counter market, the dealer acts either as principal or as agent. Acting as principal, he buys or sells securities net without any commission charge; in acting as an agent he usually adheres to commissions prescribed by the Montreal and Toronto Stock Exchanges. Very often, the over-the-counter dealer is obliged to take inventory positions in securities which he may be trading. He therefore risks his own capital in the maintenance of various positions in anticipation of a future demand for the security in question.

14. Because so many securities of varying characteristics are traded over the counter by large, medium-sized and small investment firms, it is impossible to determine the gross dollar turn-over for any given period of time. At certain times, particularly during the creation of brand new industries, such as uranium, oil and gas and the related pipelines, activity in the over-the-counter markets increases sharply; the same is true during periods of traditional natural resource development. At other times, trading in over-the-counter securities shrinks, reflecting movements only in a limited number of Canadian securities. As compared with the American market, Canada's over-the-counter market in stocks is extremely small. In the United States, there are about 5,000 unlisted issues quoted daily in American papers as opposed to only 1,600 stocks listed on the New York Stock Exchange. In Canada, the reverse would be the case, excluding penny mining shares, in that there are far more shares of Canadian companies listed on recognized stock exchanges than there are traded in the Canadian over-the-counter market.

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15. THE SUPPLY OF STOCKS The discussion now turns on the supply of shares, which constitutes one of the most important topics falling within the broad

TABLE II

Net New Security Issues

	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961 *	Total 1952-1961	%
	....	....	....	....	....	....	million dollars	....	....	....	....	
Common Stocks	$ 223	185	147	367	514	426	287	331	182	242	$ 2,904	36
Preferred Stocks	16	51	25	95	175	89	25	73	52	44	645	8
Total Equity	239	236	172	462	689	515	312	404	234	286	3,549	44
Corporate Bonds	373	375	445	324	794	954	654	108	290	275	4,592	56
Total Financing	$ 612	611	617	786	1,483	1,469	966	512	524	561	$ 8,141	100%

* Does not include the retirement of $111 million of B.C. Electric Co. held by the parent company, but does include partial distribution of $86 million to shareholders of B.C. Power.

Source: Bank of Canada Statistical Summary, December, 1961; Financial Supplement, 1958.

subject of stock business. While frequent mention is made of this supply, it is hard to analyze in terms of actual quantities. At any given moment in time, the supply may be expressed as the value of stocks on the Canadian exchanges, adjustments having been made for those listed on more than one exchange, for foreign stocks listed on Canadian exchanges and perhaps also for that proportion which is so unlikely to be traded that it cannot be regarded as forming part of any potential offering. A second measure of supply is the total of new stocks, net of redemptions, issued over a period of years. In Table II, this information is given for the period since 1952.

16. The significance of these figures is discussed in detail in the section relating to Corporation Finance. Suffice it to say here that: (a) there has been a steady post-war rise in the proportion of business capital expenditures financed internally; (b) in the period since 1952, the dollar amount of business external financing rose to a peak in 1956-1957 and has since subsided to less than half its record levels; (c) within this total, somewhat more than two-fifths has been accounted for by equity financing.

17. Among the many factors affecting the supply of Canadian stocks, the following are among the more important:

(a) Perhaps the most obvious, is the nature of Canada's economic development. The emphasis on the exploitation of Canada's natural resources is most strikingly reflected on the board of the Toronto Stock Exchange where "penny" mining shares abound; close to half of the stocks listed are in fact priced at less than $5.00. The absence of "space" stocks, the limited number of electronics, chemical and drug stocks, etc., again reflect the character of industrial growth in this country.

(b) The great importance of foreign ownership in a number of Canadian industries has resulted either in the presence in

Canada of wholly-owned subsidiaries in the operations of which the public cannot acquire a direct interest, or in the effective withdrawal from the market of the majority of a company's stock; Ford Motor Company of Canada, 75% owned by Ford of U.S., is an example of the latter process. The subject is discussed at greater length in a separate section.

(c) The extent of public ownership is a third general determinant of the availability of Canadian equities; its effects are most obvious in transportation and utilities; the expropriation of B.C. Electric is the most recent case in point.

(d) The mutualization of insurance companies provides another example of the withdrawal of stocks from the market. In the three years 1958-1960, such purchases averaged $52 million annually.

(e) Among considerations internal to corporations that affect the supply, mention should be made of the incentive to debt financing provided by the fact that interest costs are pre-taxed; indeed, every time the corporate tax rate is increased, this incentive strengthens.

(f) Also militating against equity financing is the prospect of further inflation; clearly the possibility of borrowing money having a certain purchasing power and eventually repaying it in currency with a reduced purchasing power acts as a stimulus to debt financing.

18. There are, at the same time, a number of expansionary influences on the supply of stocks. The absence of a capital gains tax, by enabling profits to be realized with no penalty to the stockholder, provides a real stimulus to trading. The 1954 revision of the Bank Act, which permitted the chartered banks to exclude certain classes of their shareholders from share offerings, enabled them to escape the disclosure requirements of the U.S. Securities Exchange Commission, and has

greatly stimulated the issue of bank shares through rights offerings. As a general comment, because of the existence of S.E.C. regulations, rights issues of Canadian companies are sometimes not offered to U.S. residents, and this has the result of adding to the supply of stocks on the Canadian markets. Perhaps, though, the most important reasons for the steadiness of the flow of new equity issues in the post-war period are: a) some companies do not have the financial standing and/or lack the type of assets that would permit financing at a reasonable cost through the sale of long term debt; b) other companies that do not suffer from these limitations nevertheless make stock issues because of the need to build up their equity base; understandably, this is particularly true where retained earnings are relatively unimportant and is characteristic of certain kinds of utilities, as for instance pipe lines and Bell Telephone.

19. From these few comments, it is apparent that among the forces affecting the supply of Canadian equities, a significant number have a restrictive influence.

20. STOCK OWNERSHIP AND SOURCES OF DEMAND FOR STOCKS The incidence of stock holdings among individual Canadians and the importance of financial institutions in Canada in the ownership of stocks are subjects which are of immense interest but on which, as a general rule, only limited statistical information is available.

Individual Investors

21. Looking first of all at the position of individuals, some broad comments can be made on the incidence of equity ownership among various income groups. In Table III the findings of two surveys covering non-farm families and unattached individuals in Canada are presented. It deserves to be pointed out that, under the wording of the questionnaire,

TABLE III

Percentage of Non-Farm Families and Unattached Individuals Owning Stocks Within Selected Income Groups.

	Income Groups					
	Under $2,000	$2,000-$4,999	$5,000-$6,999	$7,000-$9,999	$10,000 and over	All Families and Unattached Individuals
1959 (Spring)	3.1%	5.1%	12.5%	20.9%	43.7%	9.2%
1956 (March)	4.0	5.1	13.7	28.1	50.6	8.9

Note: The total of families and unattached individuals was 4,460,000 in 1958 and 4,051,000 in 1955; the family is defined as a group of individuals sharing a common dwelling unit and related by blood, marriage or adoption. Unattached individuals are persons living by themselves or rooming in a household where they are not related to other household members.

Source: D.B.S. Incomes, Liquid Assets and Indebtedness of Non-Farm Families in Canada 1955, 1958.

both publicly traded common and preferred stocks and those traded over the counter were included; the survey was not limited to Canadian equities; with respect to the treatment given to mutual funds, while the wording was somewhat ambiguous, it may be assumed that most mutual fund shareholders will have regarded themselves as stockholders in their replies.

22. From Table III, it appears that in the spring of 1959 a little over 9% of Canadian families and unattached individuals owned stocks, an increase of 50,000 from three years previously. Within the various income groups, it is not surprising to find by far the greatest incidence of ownership among the higher brackets. It should be emphasized that these figures must be treated with caution (particularly those for 1956 which are based on a considerably smaller sample than was the case in 1959); nevertheless, it is of some interest to note that the overall percentages are not very different from those obtained in the United States: a U.S. survey (Federal Reserve Bulletin, June, 1955) revealed that 8% of U.S. family units were stockholders.

23. In Table IV, some idea can be obtained of the concentration of stock ownership. In considering these figures, it should first be pointed out that they refer only to taxable persons, that is to say to persons whose taxable income exceeded their exemptions; (that this should not be too serious a limitation, however, is suggested by the fact that in 1959 dividend income reported in non-taxable returns amounted to only $10,383,000, as against a total of $296,218,000 in taxable returns). As in Table III, the findings relate to both preferred and common stocks; unlike the earlier table, however, the information is limited to holdings of stocks of taxable Canadian corporations, since it is only on these that the credit may be claimed. As to the reliability of these taxation figures, the incentive to accurate reporting provided by the dividend tax credit is obviously important; it has been estimated that the amount of

TABLE IV

Dividend Income in 1959.

	Under $2,000	$2,000-$4,999	$5,000-$6,999	$7,000-$9,999	$10,000 and over	All Income Groups
Number of Taxable Persons	662,240	2,655,522	593,143	204,128	127,457	4,242,490
No Claiming Dividend tax credit	15,725	105,397	50,115	37,344	55,022	263,603
As % of No. of Taxable persons	2.4%	4.0%	8.4%	18.3%	43.2%	6.2%
Total Dividends Received ($000)	$ 7,044	$ 49,140	$27,548	$ 31,998	$180,488	$ 296,218
As % of Total for all Income Groups	2.4%	16.6%	9.3%	10.8%	60.9%	100%

Source: Department of National Revenue.

dividends reported on the individual income tax returns represents more than 90% of actual dividend receipts.

24. Not surprisingly, the incidence of stock ownership indicated in Table IV (those claiming a dividend tax credit as a percent of total taxable persons) is lower throughout the various income groups than in Table III, where no distinction is drawn between holdings of dividend-paying and non-dividend-paying stocks. Perhaps the most interesting feature of the table is the evidence it provides of the concentration of stock ownership: 55,000 individuals, representing little more than 1¼% of all taxable persons in Canada, accounted for over 60% of dividend income reported in all taxable returns.

25. There are no figures on the actual market value of individuals' stock holdings. Statistics on the net flows of personal savings into the stock market are also conspicuously absent; it is nonetheless true that Canadians enjoy a number of incentives to stock ownership, which residents of other countries, notably the United States, lack. The absence of a capital gains tax, mentioned in the section dealing with the supply of stocks, removes a deterrent to equity ownership which exists in countries where this tax is present. The elimination in the budget of December, 1960, of the 4% surtax paid by persons with investment income of $2,500 or more - so long as the income is from Canadian sources - provided an incentive to Canadian stock ownership. Finally, this form of tax encouragement exists in what is perhaps its most effective form in the 20% dividend tax credit which is allowed Canadian residents on dividend income from Canadian corporations; incentives of a somewhat similar nature - but less powerful - exist also in the depletion allowances granted on dividends of oil, gas or mining companies.

Institutional Investors

26. The distinction that is commonly drawn between individual investors and institutional investors is, it must be admitted, somewhat forced. Considering the question of the incidence of share ownership, for instance, there is a danger of double counting; an individual owning shares in a mutual fund or having funds administered by a trust company, a proportion of which is invested in equities, will regard himself as a stockholder and will have been covered in the questionnaire discussed in the preceding section. The fact remains, however, that financial intermediaries, by their very nature, constitute major repositories of funds, which sometimes lend themselves to analysis; it is important to be aware of the different investment policies of these intermediaries and of the changes that may be taking place in such policies; indeed, one of the most interesting post-war developments has been the growth in the so-called contractual forms of personal saving, which is best illustrated in the rapid expansion of life insurance companies and pension funds.

27. The information available on institutions varies widely from being extensive in the case of pension funds to largely non-existent in that of administered trust company funds. For the purposes of this submission, there are two questions to which it seems important to try to find answers: (a) what is the net annual flow of fresh money into Canadian common stocks from the various institutions, and (b) what is the importance of existing holdings in relation to the Canadian market. To answer the first question, it would be necessary to have book value figures of Canadian common stock holdings over a period of years, the difference from year to year indicating the net participation in the Canadian equity market of each type of institution. For the second question, the market values of such investments are needed. In the following discussion, it will become apparent that in many cases both

TABLE V

Changes in Stock Holdings (Book Value)

	1955	1956	1957	1958	1959	1960	1955-1959
	....	....	....	million dollars	....	....	....
New Stock Issues	462	689	515	312	404	234	2,382
Changes in stock holdings of:							
Life Insurance Companies	14	8	1	21	11	5	55
Fire & Casualty Companies	9	8	5	8	7	N.A.	37
Trust Companies	1	6	3	1	4	2	15
Mortgage Loan Companies	7	5	1	9	3	3	25
Pension Funds	N.A.	N.A.	21	43	53	55	117
Investment Companies	44	51	35	24	77	47	231
NRO Funds	68	70	74	14	-10	-30	216
Other foreign portfolio investments	140	183	99	101	150	96	673
Total	283	331	239	221	295	-	1,369
As % of New Stock Issues	61.2%	48.0%	46.4%	71.2%	73.0%	-	57.5%

Sources: Bank of Nova Scotia Monthly Review, October, 1960; investment company reports; some figures are partially estimated.

sets of figures are not available and in some cases, those that are published, are subject to serious limitations.

28. In Table V changes in the book value holdings of selected institutions as well as in foreign portfolio investments are related to net new stock issues. Some of these findings are examined in greater detail in the following pages. As a general comment, the figures should be used with extreme caution.

29. Life Insurance Companies: In the following table, a breakdown of the assets of life insurance companies at book values is presented.

TABLE VI

Life Insurance Company Assets

As at December 31,	1954		1959		1960	
	$ million	%	$ million	%	$ million	%
Canadian Securities	3,045	58.2	3,740	50.0	3,980	49.7
Bonds	2,929	56.0	3,510	47.0	3,755	46.9
Preferred & common	116	2.2	171	2.3	176	2.2
Own Stock remutualization	-	-	59	0.7	49	0.6
Foreign Securities	169	3.2	186	2.5	191	2.4
Bonds	111	2.1	116	1.6	121	1.5
Preferred & common	58	1.1	70	0.9	70	0.9
Mortgages	1,519	29.1	2,787	37.3	3,011	37.6
Other	493	9.5	761	10.2	825	10.3
Total Assets:	5,226	100%	7,474	100%	8,007	100%

Note: Life branch assets of all companies registered under the Federal Insurance Acts, comprising all assets physically held in Canada by Canadian companies and British and foreign companies; Canadian dollar assets held outside Canada are excluded.

Source: Bank of Canada Statistical Summary, August 1961.

30. One of the most striking features of this table is the small proportion of assets invested in common stocks; indeed,

in the post-war period, life insurance company holdings as a proportion of total assets have never approached the 15% statutory limit established in 1932.

31. One difficulty in using book values to determine the net flows of investment funds into Canadian common stocks is the practice of insurance companies of writing down such figures; the incentive is provided by the fact that they are under statutory obligation to value their assets as of some particular period and show a state of complete solvency. It is therefore not necessarily true, for instance, that in 1960 the net inflow for equity investment was $5 million ($176 million less $171 million). In this connection, the monthly statistics covering the investment transactions of the 12 major life companies, published by the Bank of Canada, are of limited help, since they include purchases of insurance stocks for mutualization purposes. It is possible, however, to develop from the Reports of the Superintendent of Insurance general estimates; this source has the added virtue that Canadian common stock purchases may be isolated from trading in preferred shares and in foreign securities. In 1959, the latest year for which such statistics are available, Canadian life insurance companies purchases some $21 million of Canadian common stocks and sold $14 million, indicating a net inflow that year of $7 million. If British life insurance companies had been included, the total would be somewhat higher.

32. From the same source, the market value of life insurance company holdings of Canadian common stocks at December 31, 1959, can also be derived. These amounted to approximately $145 million for Canadian companies, $52 million for British companies and zero for other foreign companies, giving a total of $197 million, or 2½% of total assets. As a matter of general interest, the distribution of assets of life funds in respect of business transacted in the United Kingdom was given in the Radcliffe Report; in 1957 common stock holdings represented about 17% and those preferred stocks 7%. As a proportion of the value of Canadian common

stocks listed in Canada, these holdings represented 0.96%. (See Table XV below).

33. Fire and Casualty Insurance Companies: The market value of stock holdings (common and preferred, Canadian and foreign) of fire and casualty insurance companies at the end of 1959 amounted to approximately $80 million, representing 3.3% of total assets of $2.4 billion. While this proportion appears fairly low, from Table V it is apparent that annual net demand has in fact been sizeable, averaging $7 million annually between 1955 and 1959. A breakdown of stock holdings at the end of 1959, reveal that out of an estimated total of Canadian equities of some $79 million, common stocks at market value accounted for $69 million, and preferred stocks $10 million.

34. Trust Companies: Trust companies form a most important sector and one for which only limited information is available. The figures of net additions to equity holdings appearing in Table V are based on the book value of company and guaranteed funds. Company funds consist of retained earnings, the proceeds of stock issues and in some cases money borrowed from the chartered banks. Guaranteed funds are made up of deposits, on which checking privileges are available, and guaranteed trust certificates; these latter are debt instruments issued by the trust companies, normally with maturities of one to five years; the element of guarantee is provided by the fact that the trust company is required to set aside cash and eligible securities equal to the aggregate amount of these funds. The relatively short-term nature of such liabilities clearly affects the investment policies that are followed; it may be cited as one reason for the apparent modesty of equity holdings. This is illustrated in the following table.

TABLE VII

Trust Company Assets

As at December 31,	1954 $ million	1954 %	1959 $ million	1959 %	1960 $ million	1960 %
Securities	344	58.5	496	49.7	655	54.1
Bonds	326	55.4	463	46.4	620	51.2
Preferred & common	18	3.1	33	3.3	35	2.9
Mortgages	165	28.1	385	38.6	442	36.5
Other	79	13.4	118	11.7	113	9.4
Total Company & Guaranteed Funds	588	100%	999	100%	1,210	100%
Administered Funds	4,056		6,403		6,829	

Source: Bank of Canada Statistical Summary, May 1961.

35. The proportion of the assets representing company and guaranteed funds made up of equities (foreign as well as Canadian) has not displayed any market trend in recent years; Table V points up the modest role the investment of such funds has played as a net source of demand for stocks.

36. To keep these findings in perspective, it is important to remember that, as at the end of 1960, company and guaranteed funds represented only 15% of total trust company funds, 85% being made up of administered funds (estates, trusts and agency funds and safe custody accounts). In fact, the proportion is lower because book value figures of administered assets are seriously understated: some trust companies, for instance, carry stocks at par and, in the case of no par value, common shares arbitrarily assign a value of $1 a share. The extent of the distortion, however, is unknown; indeed, this is one of the areas where the inadequacy of published information is most striking. Only in the case of pension fund monies managed by trust companies is an asset break-down available; the subject is discussed at some length in the section on pension funds; at the end of 1960, corporate trusteed plans (those administered by trust companies and by

Investors Mutual) represented somewhat less than one-third of total trusteed pension funds and involved assets of $1.1 billion. Subtracting these from the total of administered funds on that date, there is $5.7 billion left on which no information is available; as already pointed out, if account is taken of the deflated nature of book value figures, the total would be increased substantially. It may be assumed that within this total, common stocks make up a significant proportion; while U.S. experience should not be treated as representative of administered funds in Canada, it is of some interest to note that in 1959 personal trust accounts in U.S. banks and trust companies were over 70% invested in equities.

37. College and Endowment Funds: Figures on investments of college and endowment funds are published annually by the Boston Fund. At the end of 1961, total assets of 62 U.S. colleges amounted to $4,399 million, of which $2,471 million or 56% was invested in common stocks, and $79 million or 1¾% in preferred stocks. Information is available on three Canadian universities (McGill, Carleton and Queen's); at the end of 1961 their assets totalled $118.1 million with common stock holdings making up $49.6 million or 42% of total assets, and preferred holdings $2.1 million or 1% of total assets.

38. Mortgage Loan Companies: Book value holdings of preferred and common stocks of mortgage loan companies (including Investors Syndicate of Canada) at the end of December, 1960 amounted to $44 million, making up 5.1% of total assets of $860 million. In 1959 the holdings were $41 million, out of total assets of $784 million. On the basis of changes in book values (see Table V), mortgage loan companies, while remaining fairly modest as a net source of demand for equities, have been more important than trust companies, considering only the investment of company and guaranteed funds.

39. Pension Funds: Pension funds form an area of institutional investment which is well documented. They fall into three

broad categories: trusteed plans (most frequently of trust companies) and annuities, notably those sold by life insurance companies and those by the Government of Canada. The Dominion Bureau of Statistics estimates the assets and reserves of all such pension plans in Canada to have amounted at the end of December, 1960 to $5,424 million, with the assets of Trusteed Pension Plans (book value) accounting for $3,616 million, those held against Life Insurance Group Annuities in Canada $1,209 million and against Federal Government Group Annuities $600 million. In 1956, the assets of Trusteed Pension Plans were estimated at $1,999 million, Life Insurance Group Annuities $646 million and Federal Government Group Annuities $930 million.

40. Most of the pension plan underwriting by the Government Annuities Branch was done between 1938 (the year it started operations) and 1948; new business done since then by the Annuities Branch has been insignificant. The substantial growth of trusteed and insurance company pension plan underwriting can be dated from the immediate post-war years. Changes in the laws governing such investments have also served to stimulate this growth. An amendment passed in 1956 to the act governing pension funds in Canada freed trusteed pension plans from a previous requirement which limited their investments to those legal for insurance companies (including a ceiling of 15% in the proportion of equities). In 1960 the law governing insurance company annuity underwriting was also altered, this same limitation being removed. In recent months a start has been made in Canada in connection with the provision of variable annuities.

41. Pension plans vary extensively as to the composition of their assets. The investments held against insurance company annuities cannot be distinguished, in the statistics that are published, from the overall assets of the companies concerned, on which some comment has already been made in an earlier section. It is in the area of trusteed pension plans that the greatest amount of information is available; they are,

TABLE VIII

Trusteed Pension Plans of Incorporated Companies

Asset Distribution at Book Value	1952		1956		1960 *		Change 1952-1960
	($ million)	%	($ million)	%	($ million)	%	($ million)
Canadian bonds	603.1	84.1	993.9	77.7	1,555.5	72.6	+ 952.4
Mortgages	29.0	4.0	96.9	7.6	167.4	7.8	+ 138.4
Canadian preferred	51.7	7.2	33.5	2.6	24.5	1.2	+ 187.6
Canadian common			72.8	5.7	214.8	10.0	
Foreign bonds, preferred	1.5	0.2	2.9	0.2	2.9	0.1	+ 24.4
Foreign common			6.0	0.5	23.0	1.1	
Other assets	32.2	4.5	73.7	5.7	154.8	7.2	+ 122.6
Total	717.5	100.0	1,279.8	100.0	2,142.8	100.0	+1,425.3
Canadian common, preferred and foreign common	53.2**	7.4	112.3	8.8	262.3	12.3	+ 209.1

* Also includes partnerships and sole ownerships.
** Includes $242,000 in foreign bonds.

Sources: D.B.S. Survey of Canadian Trusteed Pension Funds 1953, Trusteed Pension Plans Financial Statistics 1957, 1960.

of course, in terms of size, the most important of the three. The trusteed pension plans dealt with in the 1960 D.B.S. survey of that name are those of a) industry (incorporated companies, partnerships and sole ownerships), b) municipalities and municipal enterprises, c) federal and provincial crown corporations, d) federal and provincial boards and commissions, e) religious and charitable organizations, f) provincial civil service plans for three provinces, g) teachers' federation plans for seven provinces, h) educational institutions and health organizations such as hospitals, i) trade and employee associations, j) co-operatives. Returns from a total of 1,140 funds were used, covering 1,009,127 employees.

42. Within these various groups, the pension funds for which the longest run of historical information has been published are those of industry. They also happen to be the most important single sector within trusteed funds: at the end of 1960, industry plans had a book value of $2,143 million and accounted for close to 60% of the total of $3,616 million. In Table VIII the asset distribution (book value) of the plans of incorporated companies is presented for the three years 1952, 1956 and 1960. The very rapid growth in pension plans in Canada during the post-war period is illustrated in the three-fold increase in total assets between 1952 and 1960. For our purposes, the most interesting point that emerges is the even more rapid rise in equity holdings: in 1952 investments in Canadian common and preferred stocks and foreign common stocks amounted to about $53 million and made up 7.4% of the aggregate portfolio; in 1960, the absolute amount had risen to $239 million and the proportion to 12.3%. If market values were taken, this percentage would be even higher; figures are not available for 1960, but in 1959 the proportion of assets held in equities at market values amounted to 14.1% against 11.5% in terms of book values.

43. From these figures, it would seem that between 1952 and 1960 there was a net flow of funds of $209 million, or an

annual flow of $26 million, into the stock market as a result of investment decisions made by the trustees of industry pension plans. If foreign equities are excluded, the net inflows come to $188 million and $23 million a year. In connection with the calculation of flows of pension money for investment purposes on the basis of book value figures, it is worth noting that, unlike insurance companies, trusteed pension funds are under no statutory obligation to value their assets and show a state of complete solvency; this means that they can worry less about temporary declines in market prices and, moreover, that they do not have the incentive that the insurance companies have to write down the book value of their assets.

44. Before leaving the subject of industry funds and particularly their role in the Canadian equity market, special mention should be made of the <u>pooled funds</u>; they are, of course, included in the industry total. As suggested by the name, these funds are set up by trustees for the convenience of small firms whose plans are combined, thereby providing the diversity, security and yield that it would be impossible to obtain if each one were to be managed separately. What is particularly interesting is the rapidity of their growth, as well as the emphasis placed on equities. At the end of December, 1960 pooled pension fund assets (book value) totalled $93.7 million, an increase of $30.6 million over the previous year-end, indicating a monthly rate of growth of $2.5 million. The proportion invested in stocks amounted to 26.5% (22.2% in Canadian common stocks), as against 25.3% at the end of 1959. While it would be wrong to regard the experience of pooled funds as representative of the way in which fresh pension fund money is being invested, it is certainly indicative of a growing interest in equities.

45. As pointed out earlier, industry pension plans make up about three-fifths of <u>total trusteed pension plans</u>. For recent

TABLE IX

1959
Selected Trusteed Pension Plans

Investments at Market Values	Municipalities & Municipal Enterprises		Provincial Crown Corps. & Govt. Agencies		Fed. Crown Corps. & Govt. Agencies		Religious & Charitable		Educational	
	($ million)	%	($ million)	%	($ million)	%	($ million)	%	($ million)	%
Federal Govt. bonds	14.7	8.4	52.2	17.3	123.5	32.6	5.0	12.2	9.7	3.2
Provincial bonds	32.3	18.3	209.7	69.7	105.7	27.9	9.1	22.0	255.5	75.0
Municipal bonds	87.8	49.8	19.4	6.5	2.3	0.6	8.7	21.0	25.1	8.4
Canadian common stocks	5.1	2.9	.3	0.1	18.2	4.8	2.9	7.1	.5	0.2
Other investments	36.4	20.6	19.2	6.4	129.4	34.1	15.6	37.7	9.8	3.2
Total	176.3	100.0	300.8	100.0	379.1	100.0	41.3	100.0	300.6	100.0

Source: D.B.S. Trusteed Pension Plans, Financial Statistics, 1959.

years, figures are also available for the overall trusteed group. These show that at the end of 1960 holdings of Canadian common and preferred stocks at book value came to $255.1 million and $27.3 million respectively (representing 7.0% and 0.8% of total assets). What is particularly revealing is the extremely limited nature of equity holdings in the pension funds of crown corporations and government agencies; the bias towards local debt instruments is also striking. The attached Table IX brings out these two points.

46. Once again, market value statistics do not go beyond 1959: in that year the market value of Canadian common stocks held by all trusteed pension plans totalled $238.6 million, representing 7.8% of overall assets (as against 6.4% of the book value) and that of Canadian preferred stocks $29.5 million, making up 1% of total assets. As a proportion of the value of Canadian common stocks listed in Canada, these holdings represented 1.16%. (see Table XV)

47. In the year 1960, it can be estimated that the net flow of funds into Canadian common stock investments by all trusteed pension funds was $50 million (of which close to $40 million by industry pension plans); at the same time, there was a net outflow on account of Canadian preferred stocks of $4 million; net investments in bonds and mortgages amounted to about $350 million. This compares with a gross cash flow in 1960 for all trusteed pension plans of $555 million, $393 million representing employer and employee contributions and the rest almost entirely investment income. With expenditures at $154 million ($108 million being pension payments out of funds), the net cash flow in 1960 was somewhat more than $400 million. This would indicate that on average 12% of net funds available for investment is going into Canadian equities.

48. Investment Companies: From Table V it appears that mutual funds have been easily the most important domestic source of

demand for equities in the period covered. In the following table, information is presented on resident-owned investment funds, that is to say, in addition to mutual funds, closed-end funds provided they are largely owned in Canada and excluding Power Corporation and Argus Corporation.

TABLE X

Investment Companies' Assets

(Market Value)	1955	1956	1957	1958	1959	1960
	- - - - - -		million dollars		- - - - -	
Total Bonds	52	62	84	93	112	140
Total Stocks	405	448	400	520	583	598
of which preferred	44	56	55	52	47	54
Canadian common	284	323	287	425	472	467
foreign common	76	69	58	43	64	78
Total Investments	456	509	485	614	695	737
Total investments at book value	325	399	444	478	592	653

49. While a break-down of investments at book value is not readily available, it may be estimated that in 1959 the net flow of funds into Canadian common stocks amounted to around $80 million. In this connection, of course, the open-end mutual funds are of major importance; the closed-end funds are only significant to the extent that the proportions of their portfolios are switched between equities and debt, or because new money has become available for investment as a result of fresh financing. At the end of 1959, with the market value of Canadian common stocks at $472 million, holdings made up approximately 2.28% of the value of Canadian common stocks listed at the time. (see Table XV)

50. Foreign Investment: Since the end of the war, Canada has been by far the world's largest importer of private long-term capital; this has taken the form both of debt and equity capital. As indicated earlier, the extent of foreign ownership of Canadian enterprises is an important factor limiting the supply of Canadian common stocks.

TABLE XI

Non-Resident Ownership in Selected Canadian Industries

	Total Non-Resident Ownership 1948	1954	1959	of which by U.S. Residents 1948	1954	1959
Manufacturing	42%	47%	51%	35%	37%	41%
Petroleum & natural gas	-	60	63	-	57	57
Mining & smelting	39	53	59	32	47	50
Railways	45	35	27	21	15	9
Other utilities	20	14	15	16	12	12
Total of above plus merchandising	32	32	34	23	25	26

Note: The table describes the proportions of non-resident ownership of the capital employed in selected industries.

Source: D.B.S. The Canadian Balance of International Payments, 1960.

51. These figures cover both direct investment, defined to include concerns which are known to have 50% or more of their voting stock held in one country outside Canada, and portfolio investments, covering enterprises where the holdings are minority in character. The fact that the percentages relate to capital employed and that they cover also direct investment taking the form of wholly-owned subsidiaries means that it is impossible to make precise statements, on the basis of this table, regarding the extent of foreign ownership of Canadian common stocks in certain industries. It does, however, provide a fair indication of the areas where this is heaviest. At the end of 1959 the book value of the capital stock of Canadian companies owned by non residents amounted to $9,916 million, of which $7,117 million in the United States. Of these totals, direct investment accounted for $7,324 million and $5,922 million respectively.

52. Additional information is also available on international trade in outstanding Canadian stocks, as distinct from

TABLE XII

Trade in Outstanding Securities Between Canada and other Countries

	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1952-1961
	........................Net capital movements in millions of dollars........................										
Canadian Stocks	+ 72	+ 21	+129	+138	+188	+137	+ 88	+110	+ 49	+ 40	+ 972
of which with U.S.A.	+ 66	+ 5	+ 87	+ 92	+ 69	+ 5	+ 70	+ 75	+ 54	+120	+ 643
with U.K.	- 6	+ 7	+ 20	+ 28	+ 72	+ 87	+ 4	+ 7	- 16	- 61	+ 141
with all others	+ 12	+ 9	+ 22	+ 18	+ 47	+ 45	+ 14	+ 28	+ 11	- 19	+ 187
Foreign Stocks (U.S.)	+ 9	+ 12	+ 6	+ 26	+ 8	+ 47	+ 10	- 24	- 2	- 5	+ 87

Note: Prior to 1956, the U.K. figures also cover trade with other sterling area countries.

Source: D.B.S. Sales and Purchases of Securities between Canada and other countries.

investment flows arising from the flotation of new issues. In Table XII results since 1952 are presented; a positive figure indicates a net inflow of capital into Canada as a result of the sale to non-residents of either Canadian or Canadian-held foreign stocks. The figures, of course, provide no indication of the gross volume of international transactions; that these can be very large is indicated in estimates made by the D.B.S. according to which gross sales to non-residents of outstanding issues of Canadian common stocks in 1959 accounted for somewhat more than one-fifth of the value of the shares traded on the principal exchanges in Canada that year.

53. In Table V, estimates are given of the net investment flows into stocks of N.R.O. Funds and "other foreign portfolio investments". That they do not correspond to the figures presented in Table XII may be largely explained by the fact that Table V includes purchases of new issues. From the statistics presented in Table V, it is interesting to note that in the period 1955-1959 the combined stock purchases of N.R.O. funds and "other foreign portfolio investments" amounted to $887 million, and that those of the Canadian institutions covered in the table came to $555 million. While the incomplete nature of the figures on Canadian institutional buying has to be taken into account, the size of foreign buying in both absolute and relative terms is nevertheless remarkable.

54. In order to provide a balanced view of foreign participation in this country's economy, it is only fair to add that occasionally Canadians are given the opportunity to purchase stock in an enterprise that was previously a wholly-owned subsidiary of a foreign firm. Greyhound Lines of Canada is a case in point; formerly wholly owned by The Greyhound Corporation of the U.S., in 1958, 20% of its 900,000 common shares to be outstanding were offered to the public. More recently, Exquisite Form Brassieres Canada-Ltd., subsidiary of the U.S. firm, Exquisite

Form Brassieres Inc., was reorganized as a public company and, in January, 1961, a public stock offering of convertible preferred and common, equivalent to nearly 50% of the equity capitalization, was made. At the time, the president of the parent firm said that the move represented an effort to comply with the wishes of the Canadian Government, which has been urging U.S. companies to make stock in their Canadian subsidiaries available to Canadians. As another example of a company the ownership of which has been repatriated to Canada, mention may be made of Metropolitan Stores of Canada.

55. Before leaving the subject of foreign ownership, it is clearly necessary to mention <u>Canadian ownership of foreign assets</u>. At the end of 1959 total direct investment amounted to $2,309 million; if the equity of non-residents in Canadian assets abroad is taken into consideration, the figure is reduced by about $1 billion. At the same date, the book value of portfolio investments came to $1,141 million, of which $892 million in stocks.

56. A final consideration is that of <u>foreign control</u>, as distinct from ownership. While this clearly has particular relevance to matters of policy, and less to a discussion of the available supply of Canadian equities, it is convenient to treat the question briefly at this point. It may be noted that in several cases, the degree of control exceeds that of ownership.

TABLE XIII

Non-Resident Control in Selected Industries

	Total Non-Resident Control 1948	1954	1959	of which by U.S. Residents 1948	1954	1959
Manufacturing	43%	51%	57%	39%	42%	44%
Petroleum & nat. gas	-	69	75	-	67	69
Mining & smelting	40	51	61	37	49	53
Railways	3	2	2	2	2	2
Other utilities	24	8	5	24	7	4
Total of above plus merchandising	25	28	32	22	24	26

Note: In calculating control, the total book value is taken of capital employed in companies in which generally 50% or more of the voting stock is known to be held in one country outside Canada. For 1948, petroleum and natural gas is included in the other industries listed.

Source: D.B.S. The Canadian Balance of International Payments, 1960.

57. During the period under review, there has been a consistent rise in the proportions of the manufacturing, oil, natural gas, mining and smelting industries controlled abroad, very largely in the United States, while there has been a steady decline in the importance of the role of foreign investors in railroads and utilities; this latter development reflects in part the growth that has taken place in government-owned railroads and hydro-electric installations.

58. In interpreting these statistics, it should be remembered that the industries chosen are precisely those in which foreign participation is especially important. There are in fact large areas of the economy where foreign investment is insignificant, as, for instance, in agriculture, residential construction and merchandising, while in manufacturing Canadian control predominates

in textiles, clothing, beverages, many kinds of food processing and primary iron and steel.

59. Direct foreign investment in Canada has usually been in response to at least one of three goals: access to the Canadian market, access to the Commonwealth market or the exploitation of Canadian natural resources; this third aspect of foreign investment has either involved manufacturing in Canada and subsequent export of the finished goods, as in the case of newsprint, or, more commonly, shipment abroad of commodities in a semi-processed or primary form, of which iron ore, base metals and a number of other minerals are examples. In all three cases, it may be argued that without massive foreign participation, much of the investment would never have occurred, and that the costs of the investment that might have taken place would probably have been higher. The exploitation of less accessible resources and the growing complexity of modern productive processes are two developments which have tended to emphasize the privileged position of those foreign investors who have ready access to plentiful and comparatively cheap sources of capital. In addition, the rapid advances made since the war in science have served to increase considerably the technological requirements of industry, with the result that even if the savings had been available in Canada to finance these expenditures many of the necessary skills would have been lacking. The technological contribution by non-residents to Canadian growth is impossible to assess exactly, but it has undoubtedly been one of the most valuable features of foreign investment.

60. While recognizing these factors, it is nevertheless true that the existence of a large measure of such external control must lead to doubts as to whether Canadian industry will in all cases be operated in the best interests of Canada. This point was raised in the submission made by the Investment Dealers Association to the Royal Commission on Canada's Economic Prospects.

Fears have been expressed that the Canadian economy is being tied too closely to that of the United States in a subsidiary capacity, that this connection may lead to excessive economic fluctuations in Canada, and that profitable opportunities for economic expansion may be neglected or deferred due to control of Canadian resources by foreign interests; for instance, subsidiaries of U.S. companies may be prevented from tapping export markets, which are reserved for the parent companies. While these fears appear at the moment to have little real justification, nevertheless it is in the best national interest for Canada to encourage the maximum domestic ownership and control of the Canadian economy. It is desirable for political as well as economic reasons that Canadians have a feeling of full participation in the development of the country.

61. SUMMARY In concluding this discussion of the demand for and supply of Canadian common stocks, it may be useful to summarize some of the necessarily tentative findings. In Table XIV, rough estimates are given of the net purchases of Canadian common stocks from certain institutional sources.

TABLE XIV

Net Purchases of Canadian Common Stocks in 1959

	Million Dollars
Trusteed Pension Funds	$ 53
Life Insurance Companies, Canadian	11
Resident-owned Investment Funds	77
N.R.O. Funds	-10

62. These few figures are no more than a qualification to Table V, the main weakness of which is the mixing of preferred and common, foreign and Canadian equities. As a general comment, the supply of new Canadian equities may be considered to have been fairly limited in much of the post-war period, when viewed in the light of the economic expansion Canada has witnessed.

63. It is apparent from Table V, however, that, in relation to this supply, demand from selected institutional investors and from abroad has been heavy: in the period 1955-59, it was equivalent to three-fifths of new stock issues. That this buying has been concentrated on a limited list of Canadian issues is very roughly illustrated in information available on common stock holdings of Canadian and U.S. investment companies (excluding Power Corp. and Argus). In mid-1961 such companies had holdings of more than 15% of the outstanding shares of Alberta Gas Trunk, Calgary & Edmonton, Calgary Power, Canadian Export Gas, Cassiar Asbestos, Gatineau Power, Greater Winnipeg Gas, Simpsons and Union Gas. Investments representing more than 10% of the outstanding common shares included Atlas Steels, Dominion Foundries & Steel, Industrial Acceptance Corporation, Loblaw "A", Moore Corporation and Zeller's. When it is remembered that these proportions concern only investment company holdings, the concentration of institutional interest on a relatively short list of "blue chip" stocks becomes apparent. A further consideration is that where control is held in a limited number of hands, the supply of stock that is potentially available for trading is much reduced. Zeller's is an example, with W.T. Grant having a 51% interest.

64. There are several reasons for believing that this institutional demand has risen since 1959 and may strengthen further. In recent years, for instance, several obstacles to stock ownership have been removed: the relaxation of investment restrictions covering trusteed pension funds and the changes in the acts governing the operations of insurance companies which have permitted the sale of variable annuities are cases in point; the importance of equities in the new pooled pension funds has already been mentioned. In addition, a number of fresh incentives to the ownership of stocks have been created, some directed solely towards Canadian equities. As a result

TABLE XV

Institutional Stock Holdings in Canada and the United States

	..........Canadian Financial Institutions..........				....United States Financial Institutions.....		
	Holdings of Canadian Common Stocks at Mkt. Value (Dec. 31, 1959; $ million)	As % Total Assets	As % Canadian Stock Market A	B	Holdings of Equities at Mkt. Value Dec. 31, 1960; $ million	As % Total Assets	As % N.Y.S.E. List
Trusteed pension funds	$ 239	8%	1.16%	1.65%	$ 14,600	44%	3.76%
Life insurance companies	197	2½	0.96	1.37	5,000	4	1.29
Fire & casualty ins. companies	70	6	0.29	0.41	9,000	30	2.32
Investment funds (resident-owned)	472	68	2.28	3.26	14,000	70	3.61
Non-resident-owned (NRO)	331	90	1.60	2.28	-	-	-
Trust accounts with banks and trust companies	N.A.	-	-	-	37,200	73	9.59
Total listed	1,300	-	6.28	8.97	79,800	-	20.58

Notes: A: valued at $20.7 billion being the value of stocks listed on the Toronto Stock Exchange at December 31, 1959, less preferred shares, less U.S. shares, less "penny" mining shares, plus investment grade common stocks only listed in Montreal.

B: valued at $14.5 billion being the same as A less 30% being the estimated proportion of stocks owned on a permanent basis (viz. Inter-company holdings) - and in effect untradeable.

* Valued at $387.8 billion.

N.B. Nearly all figures in this table are approximations.

Sources: Canadian sources have been listed in the preceding text. U.S. sources include "Institutional Investing" by Richard W. Lambourne, Financial Analysts, Nov. - Dec. 1961.

of provisions in the supplementary budget of December, 1960, corporations wishing to qualify for tax purposes as investment companies must obtain at least three-quarters of their gross revenue in the form of dividends from taxable Canadian corporations; for pension plan trustees to qualify for tax exemption, they must derive 90% of their investment income from Canadian sources; in both cases these targets have to be reached by December, 1963.

65. In Table XV, the importance of several institutions in the Canadian market at the end of 1959 is indicated; comparisons are made with similar groups in the United States and in both cases the weight of stock holdings in relation to total assets is suggested. It must first be recognized that the figures are approximations and that the comparisons are far from being perfect; the U.S. statistics, for instance, include foreign stocks and preferred shares, while the Canadian relate only to Canadian common stocks; holdings in the two countries are as of different dates.... But these qualifications should not invalidate the general finding that equities form a much smaller proportion of the assets of institutional investors in Canada than they do in the United States. Since it was indicated earlier that there seemed to be little difference in the incidence of stock ownership among individuals in the two countries, clearly it is Canadians' indirect participation in the stock market through the various financial intermediaries that is weak in comparison with the experience of Americans.

66. Recommendations of increased equity participation by institutions assume greater holdings of foreign stocks and/or an enlarged supply of Canadian equities. In a world increasingly characterized by freedom of movement of capital, we should recognize that Canadian investors will not set themselves apart from this trend. At the same time, it seems highly desirable that maximum opportunities be provided for investment in Canadian institutions. This may take the form of rendering Canadian

stocks more attractive by the removal of certain competitive disadvantages under which Canadian firms operate in relation to foreign companies. In oil and natural gas exploration, development and production for instance, the income tax position of a Canadian corporation or individual is not as favourable as is that of an American corporation or individual. There are of course many other measures that would help to channel investment funds into Canadian equities. As an example of imaginative action in this connection, in Australia, a tax scheme has been evolved permitting an Australian to deduct from his income tax that amount which he can show evidence of having invested in the shares of new companies incorporated for the purpose of exploring for oil.

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67. INVESTMENT MANAGEMENT ROLE IN THE CANADIAN ECONOMY In the discussion so far, attention has been drawn on the need to broaden domestic ownership of equities in Canada. Investment dealers and counsellors are very conscious of this and, in their role as portfolio managers, they have done much to improve the situation. The very rapid growth in the post-war period of management services for securities has been brought about not only by the demands for sophisticated information on the part of institutional investors but also by the expanding needs of individual investors. On the one hand there has been the desire of the professional investor for more detailed and accurate information concerning companies and their public offerings of securities. Improved communication facilities, broader coverage by daily newspapers and periodicals have stimulated a greater desire on the part of the individual investor for specific advice and information.

68. The pressure exerted on investment dealers for improved investment management advice is to be explained in part by the

background of the men assuming senior positions during the past five to ten years within the investing institutions. In the period prior to the war they did little or no recruiting and, perforce, during the war years it was virtually impossible for them to expand their personnel. Subsequent to the war, a much higher percentage of more highly trained people, such as university graduates, were absorbed into the investing institutions. In addition, the increasing appeal of mutual funds and more planned investment of personal funds created greater opportunities within the industry. These highly trained people sought better sources of information on issues which were being offered by corporations, governments, etc., and this created an enlarged demand for the investment management facilities in Canada. Twenty years ago, trust companies and, in some instances, banking institutions, were alone in supplying regular information with regard to portfolio management. Today, in Canada, there are numerous investment houses, stock brokers, mutual funds and, to an even greater degree, trust companies offering portfolio management and many aspects of investment advice to an ever-growing group of people. Indeed, the task of investment management may be said to have attained professional status.

69. It might be helpful to list the various types of investors who require, either on a regular or on an intermittent basis, advice concerning their investments:

Estates
Trusts
Personal Accounts
Investment Trusts
Mutual Funds
Pension Funds
Corporate Accounts.

The type of service ranges from the determination of an overall investment policy to the provision of specific information on particular issues making up a portfolio.

70. The relationship of an investment counsel or investment manager to the investor is personal and confidential. Such factors as family obligations, educational expenses, home

ownership, types and amounts of life insurance, income from employment, all have an important bearing on many of the decisions faced in setting up a portfolio for a client. Similarly, in a corporate or insurance company portfolio, foreseeable demands on capital and income, actuarial return, etc., must be considered.

71. So much for the background of investment management and its relationship to the investor. The ideal investment is one offering a high rate of return, a good prospect of capital appreciation, a minimal risk of capital loss, and no difficulty about converting back to cash rapidly. It is very hard to find such an investment in the real world. The typical investment problem, therefore, is assigning relative orders of importance to these different criteria. The problem is always difficult because almost all investors are interested, to some extent, in each one of these advantages. Spectacular profits may be achieved through lucky speculation, and protection, nominally guaranteed through the purchase of "riskless" securities, may prove mythical when subjected to deteriorating dollar values.

72. At times, certain securities may appear relatively unattractive; at other times it may be advisable to modify the emphasis of some holdings, so that the balance between fixed income investments on the one hand and equity on the other may be shifted. The basic framework is devised in order to give due weight to the degree of protection required, the amount of risk which can be accepted and the need for income. Individual securities are selected with due regard to the preference of an investor for certain industries.

73. The securities in question can only be chosen after their merits have been carefully weighed by people highly trained in this type of research work. It is necessary for a firm, supplying investment counsel information, to maintain a research department devoted to a continuous, impartial and,

perforce, relatively successful analysis of given situations. In certain instances, firms will emphasize certain types of securities and confine their research efforts to those particular areas, but firms which offer a comprehensive investment management service must cover a broad field in Canada. This comprises extractive industries, secondary and primary manufacturing industries, and service organizations. It requires the training and development of competent personnel, who must have adequate educational background to give them the ability to collate and classify the appropriate material.

74. It has been estimated that to bring a college or university graduate to the status of a recognized analyst takes a period between four to six years. This indicates that a firm must make a fairly sizeable capital investment in an individual in order to bring him to the point where he can be useful in research. Figures in themselves are not conclusive, but it would seem that a fair estimate is that a capital investment of some $40,000 to $50,000 would be a relatively modest outlay in order to produce one good senior investment analyst. If this thought is pursued a little further, and assuming that, over a five-year period, a firm would be extremely fortunate in retaining on a permanent basis three out of seven trainees, there has to be a substantial capital investment made in order to produce the type and calibre of information required to provide the basis for successful investment or portfolio management.

75. The training, either on a permanent or a replacement basis, is, in itself, only part of the capital costs of maintaining adequate research facilities. There are substantial capital outlays for the production of informative services, involving, for instance, the use of consultants in a particular field, either on a regular or sporadic basis. In addition, it is not only desirable but necessary to provide facilities for the research staff to make extensive field trips

to the industries and companies whose activities they are analyzing so as to give them first hand knowledge of the potentialities of companies on a short-term or long-term basis. Finally, it is vital that national and international channels be developed for critical information forming a basis for the appreciation of world trends, etc. This is a costly and time-consuming operation involving capital expenditures in proportion to the coverage desired.

76. It might be pointed out in conclusion that, where investment management or portfolio advice is offered as an auxiliary service by an investment house, there is usually no added fee to the client other than the normal brokerage or commission which is chargeable on transactions. Investment counsels, however, who operate solely for that purpose do levy a fee on a varying scale in accordance with conventional terms.

77. THE IMPORTANCE OF CORPORATE PUBLIC RELATIONS POLICIES

With the best will in the world, investment dealers and counsellors would have great difficulty making sophisticated judgments on individual securities without the co-operation of the companies concerned. Indeed, competent reporting to shareholders and to the public at large is indispensable. Remarkable progress has been achieved in this respect during the past three decades, and some Canadian companies are among the leaders in the public relations field on this continent; a few of them have figured prominently in the list of trophies awarded for best annual reporting.

78. On the other hand, one must recognize that many Canadian corporations are not giving to the public, holding their shares, the information to which they are entitled. While it is hard to outline a fixed set of rules, it would seem that once a year at least, on the occasion of the annual report, shareholders should be given as complete factual,

pictorial and graphic information about the company as possible. This should include interpretation of the company's activities and policies in relation to conditions within its industry, the information being presented in such a way as to afford easy comparison with previous performance. The publication of sales figures, in this connection, is most desirable. In order to make it meaningful for the average shareholders, the report should be written in layman's language, with clear explanations of technical financial terms.

79. Preferably, information given to shareholders should not be limited to the annual report. Interim statements, on a quarterly or semi-annual basis, are highly desirable, and these should carry concise information on events affecting the company during the period covered by the interim report. Speeches made by the Chairman or the President at the annual meetings as well as answers given on that occasion to shareholders' questions should also be part of the informative material supplied annually to shareholders. It is also important that each company sees to it that any information pertaining to its activity, capitalization, earnings or dividends, which could materially affect the performance of the shares on the stock exchange, be given as early and as clearly as possible, and with wide and simultaneous distribution.

80. The challenge of gaining investors' confidence through sound public relations policies is a substantial one, but so are the rewards of communication with an audience of growing importance.

81. INVESTMENT CLUBS IN CANADA In discussing efforts made to broaden stock ownership one must mention investment clubs, in view of the important part they are playing, with the help of members of the Investment Dealers Association, in educating the small investor.

82. Investment clubs, in Canada, had their beginnings in several groups which came into existence in the late 1920's. At least two of these are still in existence and they now represent fairly large aggregates of capital. There is no real history of investment clubs in this country as, over the years, there has been no central agency through which their formation and activities could be recorded. In the past ten years, however, the growing interest in the United States has extended into Canada and, in 1955, there was formed an association called The Canadian Association of Investment Clubs. It has been estimated that in Montreal and Toronto there are now 1,000 such clubs in existence, varying from the $1.00 a week kind up to those requiring a monthly subscription of $100. Many of the clubs have come into being in the past three years. For the most part, their membership falls between 30 and 40; their goals are:

a) To provide their members with an opportunity to jointly study securities so as to broaden their investment knowledge;

b) At the same time to enable them to make their personal savings work.

83. In many instances, for two or three years the amounts of capital available for investment are minute. This means that transactions effected by these groups, if they are to have any diversification in their investments, are confined to very small lots of stocks. It is an accepted fact that the odd-lot transaction is an unprofitable one to the broker concerned, and generally the experience in dealing with investment clubs is that of carrying business at a loss. On the other hand, there is the hope that future business will develop on a large enough scale to offset these losses.

84. CO-OPERATION BETWEEN STOCK EXCHANGES AND THE INVESTMENT DEALERS ASSOCIATION Much of the public financing of Canada's post-war expansion has been done through Investment Dealers Association members across Canada.

85. In the case of equities, the value of listing on a stock exchange as a means of providing a known and ready market has been decisively demonstrated. This has made for closer co-operation between Investment Dealers Association members and the stock exchanges than existed in earlier periods of Canadian development, when equities were not as widely held by the public.

86. At the same time, the major stock exchanges have been improving their communication and reporting facilities in order to meet the public's desire for a wider diversification of issues for investment. It was almost mandatory that the stock exchanges across Canada should use every means possible to develop in an harmonious manner their relations with underwriters across Canada, who were instruments in bringing to the public new equity issues. The major stock exchanges in Canada have, over the past ten years, each in their own sphere, taken the initiative to develop a broader understanding between underwriting houses and brokerage firms who are members of the various exchanges. The pressure to maintain readily accessible markets on a continuing basis has in itself fostered a much closer co-operation between the two main sectors of equity distribution and servicing in the past fifteen years. The stock exchanges have endeavoured to make more readily available their facilities to the corporations whose issues were being underwritten. For their part, Investment Dealers Association members familiarized themselves with listing requirements, rules and regulations of the public exchanges. We believe that the complementary nature of the functions of the underwriter and the broker are much more clearly defined now in virtue of the co-operation that now exists.

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87. CONCLUSIONS AND RECOMMENDATIONS a) In this discussion, a recurring theme has been the inadequacy of the available statistical material. Such shortcomings are glaring in the case of the investment of funds administed by trust companies. It is recommended that the Dominion Bureau of Statistics give high priority to having the relevant material assembled and published.

b) On the basis of those statistics that are available, it appears that the proportion of individuals in Canada owning stocks is not very different from that in the United States; this may be in part due to the incentive to stock holding provided by the 20% dividend tax credit. It is recommended that this be fully maintained and that further study be devoted to the subject of minimizing double taxation. On the other hand, it is suggested that the Commission examine the participation in the stock market of Canadian financial institutions and pension funds and make recommendations which will encourage increased participation by them.

c) It is recommended that efforts be made to remove some of the competitive disadvantages under which some Canadian firms operate in relation to foreign firms.

d) In regard to the goal of furthering ownership of Canadian equities in Canada, while much has already been done by the companies, the stock exchanges and investment dealers, in close collaboration with the Investment Dealers' Association, further improvements are certainly possible and every effort should be made in this direction.

e) While it seems highly desirable for Canadian stock ownership to be broadened, the valuable role played by foreign capital in Canada's post-war development should not be overlooked. It is to be hoped outside money will continue to perform an important function in the years to come and, in this connection, it is vital that the favourable business climate that has been characteristic of this country be maintained.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX K

MUTUAL FUNDS

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX K

MUTUAL FUNDS

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Submission by the Investment Dealers' Association of Canada to the Royal Commission on Banking and Finance.

APPENDIX - Mutual Funds

A. INTRODUCTION

Brief history of investment companies.

1. The forefather of investment companies as such is usually recognized as the Société Générale de Belgique formed in Brussels in 1822 by William I, first king of the Netherlands. Initially it was essentially a banking and finance concern but later it developed along holding lines because of its financing operations.

2. The concept of investment trusts was really nurtured in Great Britain. In 1868, the Foreign and Colonial Government Trust was founded for the express purpose of prociding "the investor of moderate means the same advantages as the large capitalist, in diminishing the risk in Foreign and Colonial government stocks, by spreading the investment over a number of different stocks". By 1875, eighteen trusts with a paid in capital of over £6.5 million had been formed. During the 1880's the number of trusts more than doubled and the movement was only halted by the Baring Bros. Crisis in 1890.

3. The majority of earlier British trusts either had a termination date or provision in the charter for a gradual redemption of its certificates. A fixed rate - usually 6% - was payable on the certificates and earnings in excess of this, after allowance for expenses were used to redeem certificates and/or set up a surplus.

It was a normal procedure to give the holder of a certificate that was redeemed a coupon entitling him to a pro rata share of whatever assets were available when the trust was terminated.

4. The investment company concept was slow to develop in the U.S.A. The first recorded concern is Boston Personal Property Trust that was formed in 1893 and which is still in operation. It has the enviable record of paying dividends every year since its inception. The first United States companies were similar to the British trusts with the exception that few of them had specific terminating provisions. The conservative policies which were a characteristic of the British trusts had limited appeal to the more adventurous American and they attracted little attention until the late 1920's.

5. Of particular interest was the formation in 1923 of a "fixed trust" called United Bankers Oil Company which may be regarded as the real father of the modern Mutual Fund. A specified number of shares of ten Standard Oil companies were purchased and deposited as a unit in trust. Seven hundred "bankers shares" were issued against each unit of 144 shares. Several "fixed trusts" were formed during the next few years.

6. In March 1924 Massachusetts Investors Trust - the first of the open-end investment companies- was formed and in August of the same year State Street Investment Corporation obtained its initial capital. Both companies and others have stood the rigorous tests of time.

7. The speculative fever of the late 1920's found reflection in the investment companies. Between 1927

and 1930, over 700 investment trusts and investment holding companies, nearly all of which were closed-end, were formed in the United States. All too few of them subscribed to the real tenets of an investment trust and the majority could only be described as proselytes from the conservatism of the true trust. Substantial leverage in the form of debentures and preferred stock was magnified by a combination of pyramiding of one investment company into another with the common shares often having a market price in excess of the break up value.

8. In Canada, investment trusts were also relatively slow in developing. The initial trusts tended to specialize in one industry and in some respects were more holding companies than investment companies. They were practically all closed and management companies.

9. Amongst the first to be formed were Canadian Power and Paper Investments, Ltd. incorporated in 1920 and Power Corporation of Canada, Ltd. formed in 1925. By 1929 there were 49 such investment companies with assets in the order of $265 million. Some $230 million of this total was concentrated in nine trusts with Power Corporation of Canada Ltd. being by far the largest with assets of over $60 million and Consolidated Investment Corporation of Canada second with investments of $30 million.

10. While nearly all of the Canadian closed-end investment companies had leverage to a greater or lesser degree, there was very limited pyramiding when compared with their counterparts in the U.S.A.

11. This absence of pyramiding served the Canadian closed-end companies well in helping to reduce the effects of the 1929 Panic. There were reorganizations and consolidations and some liquidations amongst the poorly constituted companies. It must be noted however that generally the major Canadian closed-end trusts of 1929 won through and are in successful operation today.

12. Nevertheless, Canadian investors lost heavily on the "investment trusts" and the very term became an anathema to them. It is probable that Canadians were influenced to a degree by the understandably bitter attitude of U.S. investors towards trusts. Management as applied to investments was at a discount and the public wanted no part of it.

13. Inherently, however, the individual of more modest means still sought ways of investing to provide a combination of diversification over a known list of companies, a redemption or liquidation feature and equally importantly, ways of establishing the proper market value of his commitment.

14. The beginning in North America of fixed trusts which in most respects met the new requirement of the smaller investor, had been back in 1923. They were, however, lacking in the spectacular and aroused little interest until 1930. According to a Securities and Exchange Commission (U.S.) report published in 1939 there were 52 fixed or semi-fixed trusts in the U.S.A. at the end of 1929 and two years later there were 143. In the two years $600 million of their certificates were sold.

15. The fixed trust movement made limited headway in Canada. There are records for 1931 of four Canadian fixed trusts of which two confined their investments to purely Canadian stocks, while the two others deposited both Canadian and U.S. stocks with their trustees. Several of the larger U.S. fixed trust shares were offered for sale in Canada but the response was not good. Unfortunately there are no accurate records available as to total sales of fixed trust shares in Canada. At the end of 1961 there were only two Canadian fixed trusts reported - Diversified Income Shares of which there are two series and Trans-Canada Shares with three series of trust shares.

B. ADVENT OF MUTUAL FUNDS IN CANADA.

16. The year 1932 saw the start of a new movement in investment companies in Canada with the incorporation by Calvin Bullock of Canadian Investment Fund, Ltd. the original mutual investment company of management type in Canada.

17. The mutual fund movement developed slowly in Canada. While Canadian Investment Fund, Ltd. had grown steadily since incorporation and was held in high respect by both its shareholders and the financial community it was not until 1950 that a new mutual fund - Investors Mutual of Canada Ltd. - was started for Canadian investors. In 1947 Beaubran Corporation had been set up primarily for European investment in Canada. Corporate Investors Limited had been organized in 1931 and Commonwealth International Corporation Ltd. in 1933. Both companies are now mutual investment funds in all respects but during their more initial years their operations were essentially those of investment trusts of management type.

18. Today there are upwards of 41 mutual funds incorporated in Canada. Of these (a) 24 are essentially Canadian owned and generally come under the definition of Canadian investment companies under the Income Tax Act; (b) 4 are primarily Canadian owned with foreign investments; (c) 3 are owned primarily abroad with investments in Canada, and (d) 10 are non-resident-owned companies registered under the United States Investment Company Act of 1940. A list of the various companies and other details are given in Exhibit A.

19. Total Net Assets at market in Canadian dollars at the end of the 1960 (calendar or closest fiscal year) of the various mutual funds incorporate in Canada and investing in Canadian securities was $900 million.

20. While an investment company may be defined as an organization that combines the capital of many persons for the purchase of securities, the definition is far from adequate and in particular it makes no reference to professional management.

21. The description of purpose given in the prospectus of one of Canada's largest mutual funds presents in a concise manner the contribution of the investment company to the investing public. "The fund was formed with a view to providing a convenient medium for diversified investments under careful supervision".

22. This concept pertains basically to both closed and open end investment companies. Both types have a definite and useful role in the overall financial community and both have their advantages and disadvantages from the investors' as well as the capital users' points

of view. It is beyond the purpose of this submission to make a comparison of the respective contributions of the two types to the capital markets. Nevertheless, it has to be admitted that the dynamic growth of open-end funds in North America during the past fifteen years when compared with the relatively static position of closed-end investment companies is convincing testimony that collectively mutual funds are developing into an increasingly important sector of the financial markets. See Exhibits D and E.

C. A TYPICAL CANADIAN MUTUAL FUND

23. While there is a wide variation in objectives, management policies, procedures and operations amongst the individual mutual funds in Canada, they have sufficient features in common to permit the preparation of a description of a prototype or typical Canadian mutual fund. This prototype, in addition to being a corporate picture of a mutual fund, serves as a yardstick for measuring deviations from the average practice employed by funds to achieve their individual objectives.

24. The typical Canadian fund would have a simple capital structure consisting of a large number of redeemable special shares and a very small number of deferred shares which latter would be held by the management group. Both classes of stock have full voting rights. The holders of the Special Shares would have the right at their option to present their shares to the company for redemption at the net asset value, whereas this privilege is not available to the deferred shareholders. In all other respects the stocks rank pari passu.

25. The company would be prohibited from borrowing money, buying securities on margin or selling short. Its investments would consist of possibly 70 different common stocks of prominent Canadian companies and some common stocks of a few large U.S. corporations - 15% of the investments would be in preferred stocks and corporate bonds, a portion of which would have a conversion or similar feature and depending upon the state of the markets a larger or smaller amount of Government of Canada bonds.

26. The by-laws of the fund would prohibit it from placing more than 5% of its assets in the securities of any one corporate issuer and would also prohibit the holding of more than 5% of the voting securities of any one corporate issuer.

27. Dividends would be paid quarterly out of the income received by the fund on the securities held after allowance for corporate and other expenses. It is probable that the fund had also made provision, whereby, if the shareholder wishes, the dividend is invested, at no cost, in the Special Shares of the fund. Shareholders would also receive, quarterly, a list of securities held by the fund, together with information as to changes made during the quarter.

28. The fund would be operated by an investment mangement organization that in addition to providing office accomodation, administrative and clerical services would supply the complicated research work necessary in the professional management of the company's portfolio. Such management would be subject to the control of the nine man board of directors, four of which might well be connected with the management organization.

29. The management fee would be one half of one percent a year of the average daily net asset value of the fund, calculated and payable on a quarterly basis. Other expenses of the fund would include security transaction commission, custodian, legal, dividend paying and auditing fees together with the usual costs of shareholder reports, annual meetings, etc.

30. There would be adequate provision in the fund's charter to ensure "arms length dealing" with the investment management and members of the board of directors on all transactions other than those conducted in securities listed on a stock exchange where regular commissions or brokerage are charged.

31. The underwriter of the funds Special Shares would be the investment management organization. It would purchase the shares at their net asset value and sell them to investment dealers who in turn would sell them to their clients. The retail price would be the net asset value which would be calculated daily, plus a loading charge of 8% of the offering price. The fund also has a sliding scale of loading charges whereby the load is reduced to 5% with the purchase of $50,000 and to lower rates as the total purchases increase.

32. The bulk of the loading charge would be paid to the investment dealer who has undertaken to sell the special shares only at the net asset value plus the specified loading charge. The balance of the loading charge is retained by the underwriter to defray the expenses of prospectuses and other sales literature, advertising, etc. This charge is commented upon in more detail in paragraphs 48 to 55 inclusive.

33. The investment management organization, which is also the underwriter, has followed the practice of managements of several other larger Canadian funds of having its own sales force to sell the Special Shares direct to the public in addition to selling them to investment dealers.

D. CENSUS OF CANADIAN MUTUAL FUNDS.

34. For the purposes of this study 41 mutual funds incorporated in Canada have been examined. There are a few additional funds in Canada but these are all small and it is questionable if their combined net assets at market exceed $500,000. Also excluded from this count are mutual funds that invest only in the shares of an affiliated mutual fund. An example of this (as show in Exhibit A) is All-Canadian Compound Fund that purchases only the shares of All-Canadian Dividend Fund.

35. Of the 24 Canadian owned mutual funds studied, 12 are classified as balanced funds, 7 are essentially common stock funds and 5 are considered specialty funds. The term "balanced fund" indicates that the objectives of the fund include both a regular reasonable income and capital appreciation. The common stock fund usually has capital growth as its major objective and might well be called a growth fund.

36. The specialty funds are those that have some feature that separates them from the other two groups. Of the five specialty funds, two concentrate their investments in Canadian oil and gas and related companies; one is a mutual bond fund; one purchases only the shares of three other designated mutual funds and one has a leverage feature

whereby under specified conditions it is permitted to borrow money. This feature has not been used during the past four years.

37. The second group of mutual funds, shown in Exhibit A, are funds incorporated in Canada with their principal assets being Canadian securities but whose shares are distributed largely outside of Canada. It is not known whether sufficient amounts of their shares are held externally for them to qualify as Non-Resident-Owned Investment Corporations. All three funds are classified as the balanced type.

38. The third group of mutual funds are those incorporated in Canada as Non-Resident-Owned Investment Corporations which are registered under the United States Investment Act of 1940. There are ten of these. None of them pay dividends and all reinvest their income. Accordingly, they should be classified as growth funds.

39. The fourth group are Canadian incorporated mutual funds owned by Canadian investors but with their investments being made in the United States and Europe. There are four of these. All of them are classified as growth funds.

E. <u>TAXATION</u>

40. The Canadian Government has recognized the need of investors who wish to have the protection afforded by a diversified investment portfolio but who at the same time may not have the means, time or facilities to create and operate efficiently such a portfolio, but granting tax concessions to those which wish to pool their resources in

an investment company that complies with conditions specified in the Income Tax Act.

41. Those sections of the Income Tax Act pertaining to Investment Companies (Section 69) and to Non-Resident-Owned Investment Corporations (Section 70) are given in Exhibit B.

42. Investment companies (domestic) pay a tax of 21% of their taxable income providing they meet certain requirements and at the same time because the investment company is not exempt from tax, the Canadian shareholders of such a company are not precluded from claiming the 20% dividend credit under Section 38 of the Act.

43. To qualify as an "investment company" the following conditions must be met by the company:

(a) At least 80% of its property, through the year, must be securities or cash.

(b) At least 95% of its income must be derived from the investments mentioned in A.

(c) Not less than 85% of its gross revenue is from sources in Canada. Investment companies with less than 85% in the 1962 tax year but 75% or more are given to the 1963 tax year to meet this requirement.

(d) Not more than 25% of its gross revenue for the year was from interest. Companies with a higher gross from interest are given until 1963 to comply with this requirement.

(e) Other than Government, Provincial and Municipal securities not more than 10% of its assets must be in the securities of one corporation.

(f) There must be a minimum of 50 shareholders, none of whom hold more than 25% of the shares of the investment company.

(g) The investment company must distribute to its shareholders before the end of the taxation year at least 85% of the taxable income after allowing for the tax paid. Shareholders are entitled to the usual depletion allowances. Dividends paid to non-resident shareholders are subject to the 15% withholding tax.

44. Non-Resident-Owned Investment Corporations are also not subject to the usual rates of corporation income tax providing such an investment company elects to be so classified and meets the necessary qualifications. This special class of tax payer was originally established to attract foreign capital to Canada.

45. Providing that the company qualified as a non-resident-owned investment corporation under Section 70 of the Income Tax Act it is subject to tax of 15% on the taxable income as determined in the manner prescribed in the Act.

46. Briefly the major requirements for a company to qualify as a N.R.O. investment corporation are:

(a) At least 95% of the aggregate value of the issued shares and 100% of its bond or other indebtedness must be beneficially owned by non-resident persons.

(b) The second general qualification relates to the source of income which must be limited to that from:

i. ownership or trading securities, bills, notes or other property.

ii. lending money

iii. rents, hire or chattels, annuities, royalties, etc.

iv. estates or trusts.

(c) The principal business of the N.R.O. corporation shall not be the making of loans or the trading or dealing in mortgages, hypotheces, bills, notes, etc. Not more than 10% of the company's gross revenues may be derived from rents, hire of chattels or charter party fees.

(d) While the company may receive its income from almost any type of property as mentioned in (b) and (c) it must derive no revenue from business activities such as purchasing, processing, merchandising, manufacturing or similar activities. The receipt of any income that does not qualify disqualifies the company in toto.

F. SELLING COSTS

48. The majority of mutual funds charge the purchaser a fee, or selling charge which is over and above the net asset value of the shares. This fee - commonly called the "loading" - is, in Canada, usually between 8% and 9% of the offering price of the shares. Normally the loading is scaled down as the amount purchased increases after a certain minimum is passed.

49. A few mutual funds in Canada have a low loading charge or no charge at all at the time of purchase but levy a small redemption fee when the shares are presented for redemption.

50. It is often claimed by superficial observers that in relation to normal commission charges on the Toronto or Montreal Stock Exchanges the "loading charges" are exorbitant. Such a comparison is both fallacious and misleading as the two things compared are entirely dissimilar and several important factors are ignored.

51. A share of a mutual fund is not an ordinary "security". It not only represents pro-rata ownership in the net assets of the fund but it is in effect a service contract entitling the holder to the benefits of constant professional management at very low cost of his interest in a highly diversified and large portfolio.

52. Mutual funds shares in common with goods, services and insurance have to be "sold" and the real benefits of diversification and professional management can only be obtained if a sufficient number of shares are sold to provide a large pool of capital. Those engaged in the creation of such a pool are entitled to compensation for their efforts.

53. It should also be noted that the loading on mutual fund shares covers sale as well as purchase as usually there is no charge for redemption. Stock exchange commissions and taxes (where applicable) are charged on sales as well as on purchases.

54. Another aspect that should be considered when examining the offering price and redemption price of mutual fund shares is the spread between the bid and asked prices that normally prevail both on listed stocks and those traded over-the-counter. Set out in Exhibit C is an analysis of the difference between the total cost of the purchase of

the first fifteen common stocks on the Montreal Stock Exchange at the closing asked prices and the proceeds when they are sold at the closing bid prices for four separate days. The percentage spread between the Total Cost and the Net Proceeds ranged between 6.84% on July 21, 1957 and 4.45% on May 31, 1960.

55. The calculations set out in Exhibit C cover the purchase and sale of more than "board lots" of each stock. If, however, the individual sought some diversification by spreading a modest amount of money over a number of stocks he is likely to encounter minimum commissions and when buying or selling small or odd lots of stock a wider than normal spread between the bid and asked prices. Accordingly it is likely that the percentage spread would be higher than the examples given in Exhibit C.

G. MARKETING OF MUTUAL FUNDS.

56. Shares of mutual funds in Canada are, for the most part, sold in one or a combination of three ways. The underwriter, which is usually the fund manager, purchases the shares from the mutual fund and then sells them to investment dealers who, in turn, offer them to the investing public at the net offering price, which includes the loading charge. The investment manager, or underwriter, may also, in addition to selling to investment dealers, have his own sales force which is engaged in distribution of the shares to the investing public at exactly the same price as they are available from investment dealers. A third method is for a separate organization (with its own sales force) that is entirely independent of either the underwriter or investment dealers to purchase shares under an arrangement from

the underwriter and offer them for sale under some form of a contractual plan (described in paragraphs 61 to 65 which may well also embody term insurance.

57. In addition to mutual fund sales made as individual transactions which are conducted in the same manner pertaining to other securities, mutual fund sales are also made in increasing amounts under what are known as Accumulation or Regular Purchase Plans under which the investor is able to take advantage of "dollar cost averaging". By this is meant that the individual invests a stated amount of money at regular intervals in the shares of a mutual fund. His money will buy more shares when prices are down and less shares when prices are high. It is arithmetically proveable that at the completion of a market cycle - namely when a recognized stock exchange index of common stocks returns, in due course, to the level existing at the time of the investor's first purchase - it will be found that the market value of the combined holdings exceeds that paid for such holdings, entirely apart from any dividends that may have been received in the interim. It must be assumed that the price of the mutual fund shares will move in reasonably close conformity with the stock exchange index that is being used as a yard-stick. In most cases, however, it will be found that, because of the professional management, the mutual fund shares will have done better than the averages.

Accumulation or Regular Purchase Plans.

58. Generally speaking these plans are based on regular contributions on a monthly, bi-monthly or

quarterly basis. Dividends may or may not, as decided by the investor, be reinvested, usually at no cost to the investor.

59. (i.) Voluntary Plans - These provide a systematic method whereby the holder elects to make periodic (usually regular) purchases of a mutual fund. The bookkeeping details, reinvestment of dividends, T-4 slips, quarterly and annual reports, etc., are usually handled by the underwriter of the fund or by an independent trust company whose services are employed by the fund management.

60. The holder has the right to terminate or liquidate his plan at any time without penalty. If he decides to present his shares to the fund for redemption, he will receive the net asset value prevailing at that time.

61. (ii) Contractual Plan - In the past five years the number of contractual plans being sold have increased rapidly in Canada. This may be attributed mainly to the type of distribution being carried out by the direct sales forces of many of the funds underwriters' and also independent organizations that are engaged in selling several variations of the contractual plan.

62. Under the contractual plan, the holder agrees to make contributions for the purchase of a mutual fund shares of stipulated amounts at regular specified intervals for a pre-determined number of years, usually ten, fifteen, or twenty years. The terms of the contract carry certain penalties to the

holder in the event that he is unable to continue his payments until the maturity date of the plan.

63. Contractual plans for some mutual funds have what is known as a "front-end load". Under such a plan a material part of the total load which would be paid to carry the plan to completion is concentrated in the first two or three years of the plan. The result is that if the investor is forced to terminate the plan in the earlier years of its life, he will only recover part of the total amount he has paid in. Certain provincial regulatory bodies have objected to this "front-end load" practice and at least one fund sales organization was required to modify its contractual plan and lower the "front-end load" on sales made in those provinces. Later, the sales organization voluntarily introduced the modifications for sales in all provinces. It should be noted that the loading charge per share of the fund is unchanged from that pertaining to regular sales but a major portion of the total is collected early in the contract in anticipation of subsequent share purchases.

64. In effect, the contractual plan employs the principle of compulsory savings which to some investors may well be beneficial. On the other hand, it cannot be overlooked that if for some involuntary reason the purchaser has to terminate the plan in the earlier years of its life, he could suffer a material loss of capital without the interim compensating feature which applies to insurance.

65. Many contractual plans offer a form of reducing term insurance at additional cost to the holder. In most instances the combination of the insurance and

the contribution will provide the beneficiaries with the face amount of the plan in the event of the holders death.

66. By far the greater majority of regular purchase plans are directed to small investors - those people who are able to save and invest from $15 to $100 per month. Most mutual funds, after an initial moderate deposit, carry a low minimum contribution under the voluntary plan. This in many cases is as low as $100 per year. Contractual plans may have a minimum deposit as low as $10 a month and often require no initial deposit of larger than this amount.

H. RETIREMENT SAVINGS PLANS.

67. In 1957, the Government of Canada amended the Income Tax Act to permit any Canadian whether employee or employer to make certain tax exempt contributions to a Registered Pension Plan which would provide funds for retirement years.

68. Under the terms of the Plan, a self-employed person may contribute each year up to 10% of annual earned income with a maximum of $2,500 and such a contribution is deductible from taxable income. For those who are members of a group plan, to which their employer also contributes, the maximum deduction is $1,500. When contributions to such group plans are less than the maximum tax deductions permitted, the individual tax-payer may establish a supplementary individual registered pension plan so as to obtain the full benefit of the allowable deduction.

69. The plan-holder has the option of converting the assets of the Plan to an annuity at anytime prior to his or her 71st birthday, at which time the assets will automatically be converted under the terms of the Plan.

70. Mutual funds qualify as an investment medium for Registered Retirement Savings Plans. As a result of the introduction of Registered Pension Plans in 1957, a new outlet for fund sales has developed.

I. WITHDRAWAL PLANS.

71. A number of mutual funds provide what amounts to a bookkeeping service whereby a shareholder who had acquired a block of shares of the fund (either as a lump purchase or by gradual accumulation) may elect to liquidate a portion of his holdings at stipulated regular intervals - usually monthly but in some cases quarterly or annually.

72. This service is not in any way the payment of an annuity but constitutes simply a convenient method for a shareholder to gradually withdraw invested capital for other purposes - usually to supplement other sources of revenue. It has the advantage from the shareholders point of view of economy. In most cases the dividend being received on the shares still held are reinvested at no cost and there is no charge for the liquidation of shares.

73. The usual options available to the shareholder are:

(i) The liquidation of a sufficient number of shares on a given day each month to provide the

shareholder with a stated number of dollars.

(ii) The liquidation of a stated number of shares on a given day each month until all the shares have been redeemed. In this case, the number of dollars received will vary with the price of the stock.

74. Most of the funds providing this service require a minimum purchase or accumulation of $6,000 in its shares at the commencement of the service and that, under option one, not more than 10% of the initial invested capital may be redeemed each year.

75. With this type of service the shareholder has no guarantee that his original invested capital will not be exhausted. The funds offering this service are careful in emphasizing the absence of the guarantee. It has to be admitted, however, that, for the individual who is inexperienced investment-wise, the service can appear complicated and unless it is explained to the shareholder by a highly experienced salesman, misunderstandings could occur. Market experience over the past eleven years has been favourable to most of these services (see Exhibit F). There can, however, be no assurance or guarantee that this experience will repeat itself in the future.

J. CANADIAN MUTUAL FUND EXPERIENCE

76. A study of mutual funds in Canada is rendered more difficult because of the absence of a central supervisory body of a similar nature to the U.S. Securities and Exchange Commission to which American investment companies must report. The student of the

American scene is further helped by the presence of the National Association of Investment Companies - a non-profit organization maintained by the great majority of important registered investment companies in the United States.

77. In the United States the two first mutual funds - Massachusetts Investors Trust and State Street Investment Corporation - were formed in 1924. In Canada the first fund, Canadian Investment Fund, Ltd., was formed late in 1932. It was not until the 1950's that it was joined by other mutual funds of substance. Of the fifteen domestic mutual funds with net assets (at market) at the end of 1960 of $1 million or more each, fourteen were incorporated in or started their period of active growth during the 1950 decade. Accordingly, it has been necessary to refer from time to time to the experience in the United States to obtain longer term mass indications of trends and responses to developments.

78. Just as the investment trust of old was a British development designed "to provide the investor of modest means the same advantages as the large capitalist . . . . . by spreading the investment over a number of government loans" so it must be said that the open-end investment company or mutual fund is a distinctly United States development that in addition to permitting "the investor of modest means" to obtain the advantages of diversification, enables him to become a true participant or shareholder in actual industry under skilled professional investment management.

79. The mutual fund was slow to develop in the United States and still slower in Canada. According to the SEC Report* as at Dec. 31, 1929, there were 675 investment companies of all types in the United States with total assets of $7,157 million. Of these 19 only were open-end companies with assets of a mere $140 million.

80. The year 1932 is generally regarded by historians as the true beginning of the mutual fund in the United States. During and after that year, to date, nearly all newly organized investment companies were of the mutual fund type. In Canada, with the exception of the previously mentioned Canadian Investment Fund Ltd. and a few small Fixed Trusts, there were practically no new investment companies organized until after the War. It was not until the '50's, however, that the mutual funds became popular with the Canadian investing public.

81. Set out in Exhibit D is a record of the growth of the five largest of the Canadian owned, domestic mutual funds from the years 1950 to 1961. These five companies at the end of 1960 represented approximately 82% of the total net assets (at market) of all the 24 Canadian mutual funds and accordingly could be considered representative in the absence of detailed statistics of other funds in the earlier years. The consistent growth over the years under review of combined net assets of over 1000% is considered impressive

* Securities and Exchange Commission. Investment Trusts and Investment Companies ..... Washington, D.C., Government Printing Office 1939 - 42.

and indicative of the acceptance of mutual funds as an investment instrument.

82. Exhibit E shows the growth of United States mutual funds during the years 1940 to 1960 when Total Net Assets increased from $448 million to $17 billion. The increase from 1950 to 1960 was approximately $14.5 billion or roughly 500%.

K. RUN ON THE BANK.

83. Apprehension has been expressed from time to time that during periods of recession, international crisis and sharp or extensive declines on the market that many mutual fund shareholders would redeem their shares, thus forcing the funds to sell heavily on balance. This in turn would tend to depress stock prices still further.

84. Many careful studies of the history of the mutual funds in the United States have been made by private individuals, the National Association of Investment Companies and the Securities and Exchange Commission. It has been found that during every testing period when the markets have experienced sharp declines more shares of mutual funds are purchased than are presented for redemption.

85. Hugh Bullock, one of the leading figures in the United States investment industries, states:

> "The NIAC has figures from its mutual fund members (representing 74 percent of the assets of its mutual fund members) showing that during the 18 percent stock market decline from May to October in 1946, the public purchased shares from such funds valued at $98 million and asked the funds to redeem $39

million worth of their shares. Meanwhile the funds' purchases of portfolio securities were $117 million and their sales of portfolio securities $72 million. Ninety-six percent of the members of the NAIC (by assets) reported that at the outbreak of the Korean War, when the market declined 7 percent during the week ending June 30, 1950, investors purchased $9 of shares and redeemed $8 million. Meanwhile the mutual funds themselves purchased $14 million of portfolio securities and sold only $6 million. Then, during the week ending September 30, 1955, when President Eisenhower was first taken seriously ill and the market declined over 4 percent 82 percent of the NAIC mutual fund members (by assets) reported that investors purchased $22 million and redeemed $10 million, and the funds themselves purchased $16 million portfolio securities and sold $13 million. Similarly in the market break from October 1 to 21 in 1957 a survey of mutual funds, the assets of which represented 79 percent of the NAIC memberships', showed that the ratio of the funds' sales of their shares to repurchases of such shares was $47 million to $16 million or almost 3 to 1, while the companies purchased $81 million of portfolio securities and sold only $32 million." *

86. The 1929-32 Crisis was beyond question the severest test experienced by mutual funds. It should also be noted that this test came at a time when the mutual funds movement in the United States was of only relatively modest proportions. The SEC Report states:

"At the end of September 1929 Massachusetts Investors Trust had 298,687 shares outstanding. From that date until December 31, 1932, it was called upon to repurchase 235,016 of its outstanding shares. Thus, if no new sales of shares had been effected, the amount of assets of the company would have been reduced by almost 80% by virtue of these redemptions alone. However, at the close of 1932 this company had outstanding 951,752 shares." **

* The Story of Investment Companies by Hugh Bullock, Columbia University Press, New York, 1959 - pages 162-3.

** Report of the Securities and Exchange Commission - Investment Trusts and Investment Companies 1939 - 42.

87. No such wealth of statistics is available for Canada. It is felt, however, that the experience of Canadian Investment Fund, Ltd. from 1933 to 1961 (as shown in Exhibit G) provides much more than a hypothetical answer as to what would have occurred if the mutual fund business in Canada had been much larger.

88. During the 29 years of its existance, Canadian Investment Fund, Ltd. had net redemptions in only four years. It may be of some significance that three of these years (1945, 1946, and 1961) were in periods of high and rising market levels and not low markets. The vice-president, and treasurer of the Fund advises that in 1940, the redemptions were from non-residents of Canada and that on balance Canadians were buyers. It is possible that expropriation of dollar securities of the British Government during 1940 may have contributed to the redemptions by non-residents.

89. The experience of Investors Mutual of Canada Ltd. from 1950 to 1961 is given in Exhibit H while the overall picture of the five largest balanced funds for the same period is given in Exhibit D. Consistent growth during each of the 11 years is to be noted.

90. It is difficult to assess the importance of the trend of the Canadian incorporated N.R.O. mutual funds registered in the United States as shown in Exhibit J. While the combined figures show a rise in the number of shares outstanding and in net value of assets for the years 1955 to 1958 and a decline during the next two years, the trends of some of the individual funds do not

always conform with the overall pattern. The decline that occurred in 1959 and 1960 are of appreciable, but not damaging proportions and may well be no more than a reflection of a tendancy to be noted from time to time in many sections of the security markets of investors to repatriate part of their foreign commitments during periods of indefinite trends. At the same time it might also be suggested that some U.S. investors felt that there were more attractive domestic situations.

91. Information as to how mutual funds that have specialized in some particular industry or group of industries such as atomic energy, electronics, or oil and gas have fared during different phases of the market is not available. In Canada, there are only two funds that have specialized in a particular industry. Both of these are relatively recent incorporations. First Oil and Gas Fund was formed in 1959 and while Growth Oil and Gas Investment Fund was formed in 1952, its expansion has been quite modest.

92. It is difficult to establish any definite relationship between the size of the Canadian securities market as a whole and the participation of the mutual funds in them. The net asset value (at market) of all mutual funds in Canada at the end of 1960 was approximately $900 million. Because the assets of the Non-Resident-Owned mutual funds are almost entirely Canadian securities their net asset values at market of $337 million have been included in the $900 million figure.

93. Complete figures are not yet available but it is estimated that the net asset value (at market)

of all mutual funds in Canada at the end of 1961 was somewhat in excess of $1 billion.

94. At the end of 1961 the quoted market value of all stocks listed on the Toronto Stock Exchange was $61 billion while the market value of listings on the Montreal and Canadian Stock Exchanges was approximately $59 million. Allowing for the considerable amount of duplication arising from inter-listings the quoted market value of stocks on the Toronto, Montreal and Canadian Stock Exchanges is estimated at under $62 billion. This figure may be further refined by elimination of the market value of $34 3/4 billion of the 21 foreign companies (mainly U.S. concerns) whose shares are listed in Canada and other countries, thus leaving a market value of listed Canadian stocks at the end of 1961 in the order of $30 billion. Of this sum preferred stocks had a market value of approximately $1 billion.

95. This $30 billion market of listed Canadian stocks include shares of all grades across the entire investment spectrum from the most speculative to the most conservative. While there is no real basis for an accurate estimate, it is probable that some two-thirds of the value of the listed Canadian stocks would be of an investment grade that might make them potential candidates for inclusion in a mutual fund portfolio of today.

L. CONCLUSIONS.

96. The gradual and accelerating interest in equities throughout the Free World during the past sixty to one hundred years may be regarded as the natural evolution of man's desire to share or participate in the growing economy of the nations and thus increase his stature. It may also be said that the right as an individual to own a share in individual segments of an economy is an inherent part of the capitalistic system.

97. The Radcliffe Committee in its detailed report upon the working of the British monetary system states:

> "574. The third factor tending to drag up the bond yeild may be the most fundamental of all, but fortunately it need not be dangerous. This is the shift of investors, notably insurance companies and pension funds, from bonds to equities. This shift is partly due, no doubt, to fears of inflation; but partly also to the development of institutional facilities for investing with reasonable safety in equities, to the influence of financial journalism, and most of all, perhaps to the belief that a well-spread portfolio of equities gives the investor the chance to share in the benefits of economic growth. Experience seems to have borne out this expectation (though not as dramatically as is sometimes suggested) and, now that development of financial institutions is freer, it is reasonable to expect that the swing will continue." *

98. Recognition of the part that equities play in investment is given by the Government in the authorization of Registered Pension Funds to include common stocks in their portfolios and by permitting the acquis-

* Para. 574 - Page 212 - Report of the Committee on the Working of the Monetary System - Chairman the Rt. Hon. the Lord Radcliffe, G.B.E., Her Majesty's Stationery Office 1959, Cmnd. 827.

ition of maximum stipulated amounts of equities by insurance companies. The Government has also extended to self-employed professional or business men, the right to participate in equities in the creation of a pension estate by allowing him to deposit shares of recognized mutual funds as contributions to his Registered Pension Fund. No other direct corporation equities may be deposited. The self-employed person is thereby accorded the same privilege as if he were a member of a corporation employee pension fund.

99. Investment companies are the only financial institutions through which investors of moderate means can share directly in the risks and rewards of equity investment under professional management conservatively and with the protection of broad diversification and continued supervision. The pooled funds now being made available to investors by certain of the Canadian trust companies may well be included in the investment company classification.

100. It is not desired to discuss or make a comparison of the relative merits of the closed-end and open-end investment companies. Each has a place and useful function in the capital structure of the various economies. Each has its advantages and disadvantages, the relative merits of which may well vary with the viewpoint of the observer. A feature which renders the investment company attractive to the investor may well be a major hindrance to management in achieving certain objectives and vice versa.

101. The dynamic growth of mutual funds in the past fifteen years deduces convincingly that investors at

large are being offered or sold a security that from their viewpoint is attractive.

102. The features of redemption of shares at the holders option and professional management operating to certain established standards in a goldfish bowl alone do not, however, account for the growth of mutual funds. The other aspect is that, in common with most forms of merchandise, they have to be sold. Mutual funds provide a service which the investment dealer or a direct mutual fund salesman can afford to sell. At the same time the service fills a need not before covered, particularly for the small investor who does not have sufficient resources to justify the employment of investment counsel or who had neither the facilities nor the interest to be reviewing constantly his or her own securities.

103. There is a sufficient allowance in the sales charge (loading) to permit salesmen to cover the smaller investor personally in the city and even more so in rural areas which previously have not been serviced investment-wise to any large extent except by correspondence because it has not been possible to do so economically with the small percentage margin presently available on listed securities and in many large corporate underwritings.

104. The combined net asset value of all Canadian mutual funds investing their resources in Canada at the end of 1961 is estimated to be in excess of $1 billion. There is no way of measuring accurately

the effect of the impact of the contribution of such a sum of capital upon the Canadian economy although it must be of appreciable proportions. It is also suggested that the mutual fund sales efforts have tended to promote individual savings with an accompanying increase in money reaching the Canadian capital markets.

105. Another plus factor for mutual funds which again cannot be measured in precise terms is that they have made available to the smaller investor a sound, marketable security which in most cases is paying fair dividends that has, in many instances, taken the place of very speculative securities which have been sold by high pressure methods and without regard for the investors circumstances and requirements.

106. While it is not amenable to statistical proof, there appears to be little question that the mutual funds have a stabilizing influence in the stock market. It has been demonstrated in previous paragraphs (83 - 91) that over the years, in periods of declining markets, the mutual funds have on balance been net purchasers of securities.

107. Mutual funds have in their portfolios very large amounts of the shares of individual companies. Purchases and sales under professional management, however, are usually executed gradually over a longer period of time so that, if anything, mutual funds transactions tend to have a stabilizing influence upon the market.

108. For the individual mutual fund shareholder the understanding that he can always redeem his

shares at their net asset value and not be subject to the whims of fluctuating investor confidence in any individual situation and never be locked in to the stock combined with a detailed knowledge as to how his money is invested by professional management in a well diversified portfolio is likely to result in a sale only when the money is required for other purposes.

109. From the Canadian mutual fund point of view, certain difficulties are experienced in regard to availability of Canadian representation of appropriate quality in some industries such as electronics and automobiles together with the narrow market that exists for the stocks of some companies. The condition is not one for which there is any immediate solution. Certain types of industries have not developed to a point where public distribution of their equities is a feasible undertaking. An increasing number of subsidiaries of foreign corporations operating in Canada are making their securities available to the Canadian investing public. This, however, cannot be regarded as the complete solution as such companies are likely to be operating only in Canada whereas their parents probably will be international in scope and have a much wider diversification of products.

110. True diversification as sought by management for mutual funds is essentially international in its view and if it is to exercise its policies to the maximum benefit of its shareholders it must be, within reason, permitted to diversify its investments without regard to national boundaries.

111. While the present requirement under the Income Tax Act that not less than 85% of the gross revenues is from sources in Canada for a mutual fund to qualify as an investment company and be entitled to the 21% income tax rate, this has not, as far as is known, been a hardship on any of the mutual funds.

112. There is in Canada no special regulatory legislation for investment companies as such at either federal or provincial levels that in any way parallels the United States Investment Companies Act of 1940 which is administered by the Securities and Exchange Commission. All mutual funds in Canada are, however, subject to the federal or provincial acts under which they are incorporated as well as the various securities acts of the provinces where their shares are being offered for sale.

113. While none of these respective acts set out regulations in the specific manner of the United States Act, it is particularly worthy of note that the various Canadian mutual funds have voluntarily and individually prescribed for themselves regulations that are of a high standard.

114. No amount or kind of government regulation can guarantee good investment management or insure investors against losses. Nevertheless, it is contended that in the absence of special regulatory legislation pertaining to investment companies at either or both federal or provincial levels the various provincial Securities Com-

missions may be faced with some difficulties in protecting the investing public.

115. It is beyond the scope of this submission to discuss investment company regulation in detail. It is suggested, however, that the Commission satisfy itself that present provincial legislation provides adequate safeguards for the protection of shareholders of both open and closed end investment trusts.

116. As the sale of few if any mutual funds will be limited to one province it is essential that there is uniformity of legislation and its administration in all provinces.

117. To date, mutual funds in Canada have been essentially conservative in concept and accordingly their shares are appropriate instruments for a broad range of investors. It is logically to be expected however that in the future mutual funds of a more specialized and speculative nature will be formed and indeed such funds could well serve a useful purpose. The investor who is in a position to commit moderate amounts of risk capital in mining or oil enterprises would be provided with the advantages of employing technically qualified specialists at relatively low cost per investor in the investment of the money.

118. Initially, mutual funds in Canada were distributed through investment dealers and stock brokers who were members of the Investment Dealers' Association of Canada and/or Canadian stock exchanges whose salesmen are trained and experienced in the

securities business. Today, however, the majority of mutual fund shares are sold by salesmen employed by direct selling organizations.

119. Investor experience in mutual funds has been satisfactory and there is much public confidence in this form of investment. The attitude has been augmented by Government recognition of mutual fund shares as an acceptable investment for deposit under Registered Retirement Savings Plans of individuals. It is essential that the true concept of the mutual fund be retained in such investment companies if the public is not to be subject to being misled. It may be necessary to introduce legislation at appropriate levels to insure that securities of investment companies with different concepts, regulations and objectives are not offered to the public under the guise of mutual funds.

120. Apprehension has been voiced in regard to the methods employed by some salesmen in marketing of standard dollar "withdrawal plans" as described in paragraphs 71 to 75 inclusive of this submission. The principle involved in these plans is recognized as being a sound and desirable one for those who wish to withdraw some capital gradually, possibly to supplement investment and other revenues. Persons have been persuaded to borrow money from a bank or elsewhere in order to purchase a sufficient number of mutual fund shares to start the plan. As will be appreciated, should the market decline, such a practice could result in a serious loss of capital and financial embarrassment.

There are other records of persons liquidating life insurance policies for a similar purpose.

121. Some of the literature on "withdrawal plans" base their arguements entirely on past performance. It should be obligatory to state clearly that past performance is not necessarily a guide for the future and that such plans which pay out more than the income earned give a return on capital to the extent that the pay out exceeds net income. It should also be stated most distinctly in the sales literature that plans which guarantee monthly payments pay out so much from income and so much from capital.

122. It is appreciated that legislation cannot be substituted satisfactorily for education and experience coupled with voluntary influence in the direction of conduct. Accordingly, the announcement of the formation of a Canadian Association of Investment Companies would seem to be a most constructive development. While it is still in the formative stage, it must be said that an organization of a nature similar to the National Association of Investment Companies in the United States may be expected to make valuable contributions in the maintenance of high standards in the investment company industry as well as assisting both its members in the more technical aspects of the business and the Security Commissions of the various provinces in the introduction and administration of legislation pertaining to investment companies.

<u>RECOMMENDATION</u>

It is recommended to the Commission that consideration be given to the following suggestion:

123. That the Commission satisfy itself that there is sufficient protection under existing security acts for the adequate safeguard of shareholders of both open and closed end investment trusts, and if not to make recommendations for any additional regulatory legislation it may deem advisable.

MATERIAL DELETED

PAGES 41 AND 42 HAVE BEEN DELETED.

MUTUAL FUNDS OPERATING IN CANADA

1. Canadian Incorporations investing essentially in Canada and owned primarily in Canada.

A. BALANCED FUNDS

Investments distributed in varying proportions in common and preferred stocks and corporate and government bonds.

Name	1960 Net Asset Value(z) - millions -	Management Fee (y)
Associate Investors Limited	$ 0.7	3/10 of 1%Q
Canadian Investment Fund	127.5	1/12 of 1%Q
Champion Mutual Fund of Canada	0.9	1/24 of 1%M
Commonwealth International Corporation	44.5	1/24 of 1%M
Corporate Investors	9.7	1/8 of 1%Q
Federated Growth Fund Ltd.	0.2	1/8 of 1%Q
Fonds Collectif "A" "B" "C"	3.2	N.R.
Investors Mutual of Canada	201.0	1/8 of 1%Q
North American Fund of Canada	6.9	1/8 of 1%Q
Radisson Fund	0.6	1/2 of 1%A
Savings and Investment Corp. Mutual Fund of Canada	4.6	1/8 of 1%Q
Timed Investment Fund	1.8	1/8 of 1%Q

B. COMMON STOCK FUNDS

Investments concentrated common stocks (85% or more) nearly all of which are of Canadian corporations.

Name	1960 Net Asset Value(z) - millions -	Management Fee (y)
All-Canadian Compound Fund (x)		1/8 of 1%Q
All-Canadian Dividend Fund	$ 21.4	1/8 of 1%Q
Dominion Compound Fund	-	3/4 of 1%A
Dominion Dividend Fund	-	3/4 of 1%A
Grouped Income Shares Limited	8.4	1/8 of 1%Q
Investors Growth Fund of Canada Ltd.	46.5	1/8 of 1%Q
Mutual Accumulating Fund	26.0	4/10 of 1%A
Mutual Income Fund (xx)	-	4/10 of 1%A
United Accumulative Fund Ltd.	4.5	1/24 of 1%M
	106.8	

(x) These are recent incorporations.
(xx) Invests only in the shares of Mutual Accumulating Fund.
(y) Expressed as a percentage of net asset value at market.
(z) At market.

EXHIBIT "A"
Page 2

C. SPECIALTY FUNDS

Mutual Funds that either specialize in certain classes of Canadian securities or whose objectives or features differ from those of the average balanced mutual fund.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
Commonwealth International Leverage Fund Ltd. (fund is permitted to borrow money)	$ 4.8	1/2 of 1%A
First Oil and Gas Fund Ltd. (invests in Canadian petroleum and related industries)	5.3	1/8 of 1%Q
Growth Oil and Gas (invests in Canadian oil and gas industry)	0.2	-
Mutual Bond Fund	1.6	1/10 of 1%Q
Supervised Executive Fund Ltd. (1955)	-	-
1956 Supervised Executive Fund Ltd.	-	-
1957 Supervised Executive Fund Ltd.	-	-
1958 Executive Fund of Canada Ltd.	-	-
	$11.9	

The 1955, 1956 & 1957 Funds invest only in shares of 1958 Executive Fund which in turn purchases the shares of Supervised Income, Supervised Growth and Supervised American Fund. Investments of 1958 Executive Fund at the end of 1960 were $813,061.

(z) At market.
(y) Expressed as a percentage of net asset value at market.

2. Mutual Funds incorporated in Canada and investing principally in Canadian stocks but whose shares are distributed largely outside of Canada and held chiefly by European investors.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
Beaubran Corporation (French, Swiss and Belgian investors)	$ 13.9	-
Cana Fund Company Limited (Swiss, Belgian and Dutch investors)	20.1	1%A
Dominion Investments Ltd.	9.0	-
	43.0	

3. Canadian Incorporated Non-Resident Owned Mutual Funds registered under the United States Investment Company Act of 1940. These funds pay no dividends and reinvest all income.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
Axe-Templeton Growth Fund of Canada Ltd.	$ 5.4	1/8 of 1%Q
Canada General Fund Ltd.	71.1	3/32 of 1%Q
Canadian International Growth Fund Ltd.	11.1	3/32 of 1%Q

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
Investors Group Canadian Fund Ltd.	$119.9	1/8 of 1%Q
Keystone Fund of Canada Ltd.	15.3	3/4 of 1%A
Loomis-Sayles Fund of Canada Ltd.	16.5	5/8 of 1%A
New York Capital Fund, Ltd.	28.7	1/8 of 1%Q
Scudder Fund of Canada, Ltd.	49.9	5/32 of 1%Q
U.B.S. Fund of Canada Ltd.	3.5	5/32 of 1%Q
United Funds Canada Ltd.	15.9	1/2 of 1%A
	$337.3	

4. Canadian incorporated Mutual Funds held by Canadian investors with investments being made in the United States and Europe.

Name	1960 Net Asset Value (z) - millions -	Management Fee (y)
American Growth Fund Limited	$ 12.4	1/2 of 1%A
Canadian Growth Fund (x)	-	3/16 of 1%Q
European Growth Fund Limited (x)	-	3/16 of 1%Q
Supervised American Fund	0.2	1/360 of 1%D
	$12.6	

(x) These are recent incorporations.
(y) Expressed as a percentage of net asset value at market.
(z) At market.

SUMMARY

	Number	1960 Net Asset Value (At Market) - millions -
1. Canadian Owned Funds		
A. Balanced	12	$ 401.6
B. Common Stock Funds	7	106.8
C. Specialty	5	11.9
		$ 520.3
2. Canadian incorporated - foreign owned funds	3	43.0
3. Canadian NRO Funds registered in U.S.A.	10	337.3
		$ 900.6
4. Canadian owned Funds for foreign investment	4	$ 12.6

INCOME TAX ACT
R. S. C. 1952 c. 148 with amendments
Sections 69 and 70

INVESTMENT COMPANIES

69. (1) The tax payable under this part by a corporation for a taxation year when it was an investment company is an amount equal to 18% of its taxable income for the year.

(2) In this Act, "investment company" means a corporation that, in respect of the taxation year in respect of which the expression is being applied, complied with the following conditions:

(a) at least 80% of its property was, throughout the year, shares, bonds, marketable securities or cash,

(b) not less than 95% of its income for the year was derived from investments mentioned in paragraph (a)

*(ba) not less than 85% of its gross revenue for the year was from sources in Canada.

**(bb) not more than 25% of its gross revenue for the year was from interest.

(c) at no time in the year did more than 10% of its property consist of shares, bonds or securities of any one corporation or debtor other than Her Majesty in right of Canada or of a province or a Canadian municipality,

(d) at no time in the year was the number of shareholders of the corporation less than 50, none of whom at any time in the year held more than 25% of the shares of the capital stock of the corporation, and

(e) an amount not less than 85% of its taxable income plus exempt income for the year (other than dividends or interests received in the form of shares, bonds or other securities that have not been sold before the end of the taxation year) minus

i. 21% of its taxable income for the year and

ii. taxes paid in the year to other governments,

was distributed to the shareholders before the end of the year.

(f) Repealed. 1955, c. 54, s. 14(3).

(g) Repealed. 1957, c. 29, s. 15.

* **NOTE:** Applicable to taxation years commencing in 1961 and subsequent taxation years, except that

(a) in the case of a corporation less than 85% but not less than 75% of the gross revenue of which for its taxation year commencing in 1960 was from sources in Canada, the expression "85%" in paragraph (ba) of subsection (2) of section 69 as enacted by section 7 of chapter 17 of the Statutes of 1960 - 61 shall, in its application to the taxation years of the corporation commencing in 1961 and 1962 be read as "75%".

(b) in the case of a corporation less than 75% of the gross revenue of which for its taxation year commencing in 1960 was from sources in Canada, the expression "85%" in paragraph (ba) of subsection (2) of section 69 as enacted by section 7 of chapter 17 of the Statutes of 1960 - 61 shall, in its application to the taxation year of the corporation commencing in 1961, be read as "60%" and in its application to the taxation year of the corporation commencing in 1962, be read as "75%":

(c) in the case of a corporation more than 25% but not more than 30% of the gross revenue of which for its taxation year commencing in 1960 was from interest, the expression "25%" in paragraph (bb) of subsection (2) of section 69 as enacted by section 7 of chapter 17 of the Statutes of 1960-61 shall, in its application to the taxation years of the corporation commencing in 1961 and 1962, be read as "30%"; and

(d) in the case of a corporation more than 30% of the gross revenue of which for its taxation year commencing 1960 was from interest, the expression "25%" in paragraph (bb) of subsection (2) of section 69 as enacted by section 7 of chapter 17 of the Statutes of 1960- 61 shall, in its application to the taxation year of the corporation commencing in 1961, be read as "40%" and in its application to the taxation year of the corporation commencing in 1962, be read as "30%". (1960-61, c. 17.s.7(2).)

NON-RESIDENT-OWNED INVESTMENT CORPORATIONS

70. (1) In computing the taxable income of a non-resident-owned investment corporation for a taxation year, notwithstanding Division C, no deduction may be made from its income for the year except

(a) dividends and interest received in the year from other non-resident-owned investment corporation, and

(b) taxes paid to the government of a country other than Canada in respect of any part of the income of the corporation for the year derived from sources therein,

and in computing its income no deduction shall be made in respect of interest on its bonds, debentures, securities or other indebtedness and no deduction shall be made under paragraph (b) of subsection (1) of section 11 or subsection (2) of section 11.

(2) The tax payable under this Part by a corporation for a taxation year when it was a non-resident-owned investment corporation is an amount equal to 15% of its taxable income for the year.

(3) No deduction from the tax payable under this Part by a non-resident-owned investment corporation may be made under Section 40 or in respect of tax paid to the government of a country other than Canada.

(4) In this Act, a "non-resident-owned investment corporation" means a corporation incorporated in Canada that during the whole of the taxation year in respect of which the expression is being applied complied with the following conditions:

(a) at least 95% of the aggregate value of its issued shares and all of its bonds, debentures and other funded indebtedness were

i. beneficially owned by non-resident persons,

ii. owned by trustees for the benefit of non-resident persons or their unborn issue, or

iii. owned by a corporation, whether incorporated in Canada or elsewhere, at least 95% of the aggregate value of the issued shares of which and all of the bonds, debentures and other

iii. (cont) funded indebtedness of which where beneficially owned by non-resident persons or owned by trustees for the benefit of non-resident persons or their unborn issue or by several such corporations;

(b) its income was derived from

i. ownership of or trading or dealing in bonds, shares, debentures, mortgages, hypothecs, bills, notes or any interest therein,

ii. lending money with or without security,

iii. rents, hire of chattels, charterparty fees or remunerations, annuities, royalties, interest or dividends, or

iv. estates or trusts;

(ba) not more than 10% of its gross revenue was derived from rents, hire of chattels, charterparty fees or charterparty remunerations;

(c) its principal business was not

i. the making of loans, or

ii. trading or dealing in mortgages, hypothecs, bills, notes or other similar property or any interest therein;

(d) it has, not later than 90 days after the commencement of the taxation year, elected in prescribed manner to be taxed under this section; and

(e) it has not, before the taxation year, revoked in a prescribed manner the elections so made by it. 1948, c.52, s.63; 1949 (2nd Sess.), c.25, s.32; 1952, c.29, s.20.

AN ANALYSIS OF THE FIRST FIFTEEN COMMON STOCKS HAVING BOTH A BID AND ASKED PRICE IN THE MONTREAL STOCK EXCHANGE OFFICIAL DAILY NEWS AS OF THE CLOSE OF BUSINESS SHOWING THE DIFFERENCE BETWEEN THE TOTAL COST OF SHARES PURCHASED AT THE ASKED PRICES, AND THE PROCEEDS WHEN THEY ARE SOLD AT THE BID PRICES

As at May 31, 1960

	Asked Price Per Sh.	Comm-ission	Shares Bought	Total Cost	Bid Price Per Sh.	Comm-ission	Net Proceeds
Abitibi	$41-1/4	$0.40	240.0	$10,000	$40-3/4	$0.40	$ 9,684
Acadia Atl. Sugar	10-1/4	0.25	952.3	10,000	9-3/4	0.20	9,094
Agnew Surpass Shoe	19	0.30	518.1	10,000	18	0.30	9,170
Algoma Steel	35	0.35	282.8	10,000	34-3/4	0.35	9,728
Aluminium Ltd.	32-3/8	0.35	305.5	10,000	32-1/8	0.35	9,707
Argus Corp.	30-1/8	0.35	328.1	10,000	30	0.35	9,728
Asbestos Corp.	25	0.35	394.4	10,000	24-1/2	0.30	9,544
Atlas Steels	22	0.30	448.4	10,000	20-1/8	0.30	9,058
Bank of Montreal	51	0.40	194.5	10,000	50-1/2	0.40	9,744
Bk. of Nova Scotia	62-3/4	0.45	158.2	10,000	62-1/4	0.45	9,777
Banq. Cdn. Nationale	51	0.40	194.5	10,000	50-1/2	0.40	9,744
Banq. Provinciale	35	0.35	282.8	10,000	33-3/4	0.35	9,446
Bathurst P.& P."A"	44	0.40	225.2	10,000	43-1/4	0.40	9,650
Bathurst P.& P."B"	33	0.35	299.8	10,000	32	0.35	9,489
Bell Telephone	45	0.40	220.2	10,000	44-3/4	0.40	9,766
				$150,000			$143,330

SUMMARY
15 Common Stocks

Total Cost	$150,000
Net Proceeds	143,330
"Spread"	$ 6,670
Percentage "Spread"	4.45%

As at April 29, 1960

	Asked Price Per Sh.	Comm-ission	Shares Bought	Total Cost	Bid Price Per Sh.	Comm-ission	Net Proceeds
Abitibi	$38-1/4	$0.35	259.1	$10,000	$38	$0.35	$ 9,755
Agnew Surpass Shoe	19-1/4	0.30	511.5	10,000	18-5/8	0.30	9,373
Algoma Steel	33-3/4	0.35	293.25	10,000	33	0.35	9,575
Aluminium Ltd.	28-3/4	0.35	343.6	10,000	28-5/8	0.35	9,715
Argus Corp.	32	0.35	309.1	10,000	28-1/8	0.35	8,585
Asbestos Corp.	26	0.35	379.5	10,000	24-1/2	0.30	9,184
Atlas Steels	23-1/2	0.30	420.1	10,000	23	0.30	9,536
Bank of Montreal	49-3/4	0.40	199.4	10,000	49-1/4	0.40	9,741
Bk. of Nova Scotia	60	0.45	165.4	10,000	59-3/4	0.40	9,816
Banq. Cdn. Nationale	50-1/2	0.40	196.4	10,000	49-1/2	0.40	9,643
Banq. Provinciale	36	0.35	275.1	10,000	35	0.35	9,532
Bathurst P.& P."A"	45	0.40	220.2	10,000	44	0.40	9,601
Bathurst P.& P."B"	32-1/2	0.35	304.4	10,000	31	0.35	9,330
Bell Telephone	44-5/8	0.40	222.0	10,000	44-1/2	0.40	9,790
Bowater Paper	8	0.20	1,219.5	10,000	7-1/2	0.20	8,902
				$150,000			$142,079

SUMMARY
15 Common Stocks

Total Cost	$150,000
Net Proceeds	142,079
"Spread"	$ 7,921
Percentage "Spread"	5.28%

AN ANALYSIS OF THE FIRST FIFTEEN COMMON STOCKS HAVING BOTH A BID AND ASKED PRICE IN THE MONTREAL STOCK EXCHANGE OFFICIAL DAILY NEWS AS OF THE CLOSE OF BUSINESS SHOWING THE DIFFERENCE BETWEEN THE TOTAL COST OF SHARES PURCHASED AT THE ASKED PRICES, AND THE PROCEEDS WHEN THEY ARE SOLD AT THE BID PRICES

As at June 21, 1957

	Asked Price Per Sh.	Commission	Shares Bought	Total Cost	Bid Price Per Sh.	Commission	Net Proceeds
Agnew Surpass Shoe	$ 8	$0.20	1,234.5	$10,000	$ 7-3/4	$0.20	$ 9,320
Aluminum Ltd.	44-1/2	0.40	222.7	10,000	44-1/4	0.40	9,765
Argus Corp.	17	0.30	578.0	10,000	16-1/2	0.30	9,364
Asbestos Corp.	31-1/2	0.35	313.9	10,000	31	0.35	9,621
Atlas Steels	25-3/4	0.35	383.1	10,000	25	0.35	9,712
Bank of Montreal	47-3/8	0.40	209.3	10,000	47	0.40	9,753
Bell Telephone	40-7/8	0.40	242.2	10,000	40-3/4	0.40	9,773
Brazilian Traction	9-3/4	0.20	1,005.0	10,000	9-1/2	0.20	9,347
B.A. Oil	53-1/4	0.40	186.3	10,000	52-1/4	0.40	9,660
B.C. Power	51-1/2	0.40	192.6	10,000	51	0.40	9,746
B.C. Telephone	44	0.40	225.2	10,000	43-1/2	0.40	9,706
Bruck Mills "A"	7	0.15	1,398.6	10,000	6-1/2	0.15	8,881
Bruck Mills "B"	2-3/4	0.06	3,558.7	10,000	2	0.06	6,904
Building Products	35	0.35	282.8	10,000	33	0.35	9,233
Bulolo Gold Dredging	4.00	0.10	2,439.0	10,000	3.75	0.08	8,951
				$150,000			$139,736

SUMMARY
15 Common Stocks

Total Cost	$150,000
Net Proceeds	139,736
"Spread"	$ 10,264
Percentage "Spread"	6.84%

As at November 2, 1956

	Asked Price Per Sh.	Commission	Shares Bought	Total Cost	Bid Price Per Sh.	Commission	Net Proceeds
Abitibi	$34-5/8	$0.35	285.9	$10,000	$34-1/2	$0.35	$ 9,763
Acadia Atl. Sugar	8-5/8	0.20	1,133.2	10,000	8-1/2	0.20	9,406
Algoma Steel	111	0.60	89.6	10,000	110	0.60	9,802
Aluminum Ltd.	121	0.60	82.25	10,000	119-3/4	0.60	9,800
Argus Corp.	18-1/2	0.30	531.9	10,000	17-3/4	0.30	9,282
Asbestos Corp.	37	0.35	267.75	10,000	35-1/2	0.35	9,411
Atlas Steels	29-1/2	0.35	335.1	10,000	29-1/4	0.35	9,684
Bank of Montreal	50	0.40	198.5	10,000	49-1/2	0.40	9,746
Bk.of Nova Scotia	55-1/2	0.40	178.9	10,000	55	0.40	9,768
Banq.Cdn.Nationale	40-1/2	0.40	244.5	10,000	40	0.40	9,682
Bell Telephone	45-7/8	0.40	216.1	10,000	45-5/8	0.40	9,773
Brazilian Traction	7-1/2	0.20	1,298.7	10,000	7-3/8	0.15	9,383
B.A. Bank Note	35	0.35	282.9	10,000	30	0.35	8,388
B.A. Oil Co.	46	0.40	215.6	10,000	45-3/4	0.40	9,777
B.C. Forest Prod.	13-1/4	0.25	740.75	10,000	13	0.25	9,445
				$150,000			$143,112

SUMMARY
15 Common Stocks

Total Cost	$150,000
Net Proceeds	143,112
"Spread"	$ 6,888
Percentage "Spread"	4.59%

REPRESENTATIVE CANADIAN MUTUAL FUNDS

TOTAL NET ASSETS AT MARKET

	1961	1960	1959	1958	1957	1956	1955	1954	1953	1952	1951	1950
	- - -	- - -	- - -	- - -	- - -	- - -	$000,000	- - -	- - -	- - -	- - -	- - -
1. C.I.F.	151.2	127.5	126.6	120.2	83.8	86.7	79.3	63.8	54.8	45.7	44.6	39.3
2. Common Int.	61.6	44.4	35.4	20.1	10.6	10.8	12.2	10.7	8.5	9.1	10.2	7.8
3. Mut. Accum. (a)	38.7	27.1	24.3	18.4	13.4	14.7	11.1	5.3	2.3	1.3	0.7	0.4
4. Inv. Mut.	277.3	201.0	189.6	162.3	122.7	115.5	82.0	45.6	28.4	19.1	11.5	2.5
5. All-Cdn. Divd. (b)	26.7	21.4	24.7	18.6	8.0	7.3	4.9	1.1	-	-	-	-
TOTAL	555.5	420.4	400.6	339.6	238.5	235.0	189.5	126.5	85.0	75.2	67.0	50.0

(a) Includes Mutual Income Fund.
(b) Includes All-Canadian Compound Fund.

1. Canadian Investment Fund Ltd.
2. Commonwealth International Corporation Ltd.
3. Mutual Accumulating Fund.
4. Investors Mutual of Canada Ltd.
5. All-Canadian Dividend Fund.

STATISTICAL SUMMARY OF OPEN-END UNITED STATES INVESTMENT COMPANIES (MUTUAL FUNDS)

Year	No. of Companies Reporting	Total(1) Net Assets ($000)	Share-holder (1) Accts. In Force	Shares Sold ($000)	Shares Redeemed ($000)	% Red. to Sales
1940	68	447,959	295,056	N. A.	N. A.	-
1941	68	401,611	293,251	53,312	45,024	84.4
1942	68	468,580	312,609	73,140	25,440	34.8
1943	68	653,653	341,435	116,062	51,221	44.1
1944	68	882,191	421,675	169,228	70,815	41.8
1945	73	1,284,185	497,875	292,359	109,978	37.6
1946	74	1,311,108	580,221	370,353	143,612	38.8
1947	80	1,409,165	672,543	266,924	88,732	33.2
1948	87	1,505,762	722,118	273,787	127,171	46.4
1949	91	1,973,547	842,198	385,526	107,587	27.9
1950	98	2,530,563	938,651	518,811	280,728	54.1
1951	103	3,129,629	1,110,432	674,610	321,550	47.7
1952	110	3,931,407	1,359,000	782,902	196,022	25.0
1953	110	4,146,061	1,537,250	672,005	238,778	35.5
1954	115	6,109,390	1,703,846	862,817	399,702	46.3
1955	125	7,837,524	2,085,325	1,207,458	442,550	36.6
1956	135	9,046,431	2,580,049	1,346,738	432,750	32.1
1957	143	8,714,143	3,110,392	1,390,557	405,716	29.2
1958	151	13,242,388	3,630,096	1,619,768	511,263	31.6
1959	155	15,817,962	4,276,077	2,279,982	785,627	34.4
1960	161	17,025,684	4,897,600	2,097,246	841,815	40.1

(1) At year end.

Source Material: National Association of Investment Companies.

EIGHT LARGEST U.S. DOMESTIC OPEN-END FUNDS

	*	Net Assets at Market 1960	1959	1958	1957	1956	1955	Shares Outstanding (x) 1960	1959	1958	1957	1956	1955
		- - -	- - -	- - -	millions	- - -	- - -	- - -	- - -	- - -	millions	- - -	- - -
1. Affiliated Fund	1934	586	575	478	346	358	336	82.9	76.1	68.8	63.1	60.1	55.6
2. Fundamental Investors	1932	591	599	515	335	372	320	66.2	62.0	56.4	50.1	45.0	40.9
3. Investors Mutual	1940	1,505	1,413	1,217	997	954	847	150.4	138.6	125.3	116.6	104.8	93.2
4. Investors Stock Fund	1945	638	559	380	233	205	133	41.6	33.9	24.9	19.9	15.4	10.9
5. Massachusetts Invest. Trust	1924	1,508	1,558	1,432	976	1,098	957	114.5	111.8	107.3	100.5	94.5	87.3
6. National Securities Series	1940	440	467	388	276	284	249	76.2	70.4	65.4	54.3	41.7	36.4
7. United Funds, Inc.	1940	863	748	559	342	349	273	73.4	62.2	50.5	40.7	33.1	27.3
8. Wellington Fund	1928	1,087	1,017	858	604	579	497	81.0	71.9	61.8	52.3	44.6	37.2
		7,218	6,936	5,827	4,109	4,199	3,612	686.2	626.9	560.4	497.5	439.2	388.8

(x) Adjusted for stock splits.
* Date of Incorporation.

ILLUSTRATION OF WITHDRAWAL PLAN
1950 - 1961
(discussed in paras. 71-75)

ELEVEN YEAR (PLUS 10 MONTHS) SUMMARY OF $25,000
INVESTED IN INVESTORS MUTUAL OF CANADA LTD.* ON MARCH 1, 1950
AND MONTHLY REDEMPTIONS OF $200.00 COMMENCING
ONE YEAR AFTER ORIGINAL INVESTMENT

ALL DIVIDENDS RE-INVESTED

March 1, 1950 - Original Investment (4,672,897 shares @ $5.35)	$25,000.00
Total Dividends Re-invested (11 years, 10 months)	$14,306.20
Total Redemptions (130 x $200) (10 years, 10 months)	$26,000.00
December 31, 1961 - Value of Remaining Shares (3,371,649 x $13,356)	$45,031.74

* Extract from Company's literature which also carries the following statement:

"WHILE THE FOREGOING FIGURES ARE BASED ON ACTUAL PAST PERFORMANCE THEY CANNOT BE CONSTRUED AS AN INDICATION OR GUARANTEE OF FUTURE PERFORMANCE".

SUMMARY OF ACCOUNT AS AT DECEMBER 31 OF EACH YEAR

March 1, 1950 - Original Investment $25,000.00
(4,672,897 shares @ $5.35)

Dec. 31,	Number of Shares	Price per Share	Value
1950	4,783.148	5.750	27,503.10
1951	4,679.923	6.490	30,372.70
1952	4,506.600	6.431	28,981.94
1953	4,326.335	6.395	27,666.91
1954	4,159.718	8.379	34,854.28
1955	4,029.292	9.710	39,124.43
1956	3,912.979	10.112	39,568.04
1957	3,798.411	8.950	33,995.78
1958	3,675.277	11.117	40,858.05
1959	3,568.972	11.219	40.040.30
1960	3,463.626	11.368	39,374.50
1961	3,371.649	13.356	45,031.74

CANADIAN INVESTMENT FUND, LTD.

Year	No. Shares Issued	No. Shares Redeemed	No. Shares Outstanding	Total Net Assets	No. of Share-holders
1933	242,004	NIL	242,004	733,771	N.A.
1934	503,929	NIL	745,933	2,473,785	N.A.
1935	248,749	86,720	907,962	3,593,667	N.A.
1936	299,170	66,800	1,140,332	5,496,068	N.A.
1937	507,106	NIL	1,647,438	5,819,789	3,205
1938	509,204	1,000	2,155,642	8,990,290	4,351
1939	329,242	95,749	2,389,135	10,002,339	4,772
1940	103,021	217,410	2,274,746	7,829,966	4,784
1941	114,757	97,790	2,291,713	7,164,996	4,815
1942	200,580	18,982	2,473,311	8,255,541	4,952
1943	87,862	27,638	2,533,535	9,370,107	5,061
1944	166,135	24,949	2,674,721	10,993,437	5,216
1945	49,717	167,299	2,557,139	12,982,480	5,126
1946	129,497	166,318	2,520,318	11,862,364	5,141
1947	228,705	25,192	2,723,831	12,554,079	5,781
1948	411,920	32,450	3,013,301	14,452,824	6,325
1949	1,988,451	13,732	5,078,020	25,318,567	10,398
1950	1,672,608	13,533	6,731,095	39,277,667	14,133
1951	296,070	90,754	6,942,411	44,561,661	15,059
1952	295,178	54,269	7,183,320	45,718,056	16,171
1953	496,462	22,821	7,656,961	45,803,482	17,005
1954	817,645	340,036	8,134,570	63,843,602	17,636
1955	704,019	65,106	8,773,483	79,335,996	18,260
1956	902,667	45,592	9,630,558	86,720,977	19,409
1957	1,285,462	110,736	10,805,284	83,821,628	20,706
1958	2,265,651	58,952	13,011,983	120,195,297	23,651
1959	1,191,255	231,696	13,971,542	126,632,665	24,687
1960	754,820	339,441	14,386,921	127,466,674	24,786
1961	554,841	919,500	14,022,262	151,207,107	23,423

INVESTORS MUTUAL OF CANADA LTD.

Fiscal Year Ended Oct. 31	Shares Issued	Shares Redeemed	Shares Outstanding	Number of Share-holders
1950	465,957.590	602.720	465,354.870	1,801
1951	1,368,639.280	50,579.620	1,783,414.530	6,086
1952	1,399,583.380	108,610.560	3,074,387.350	9,862
1953	1,644,376.210	183,940.280	4,534,823.280	13,358
1954	1,859,376.770	389,232.660	6,004,967.390	16,187
1955	3,149,463.260	373,193.260	8,781,237.390	23,196
1956	3,514,894.800	585,529.436	11,710,402.754	32,585
1957	3,096,183.693	929,231.217	13,877,355.230	40,168
1958	2,361,522.447	1,081,274.226	15,157,603.451	41,768
1959	3,359,443.735	1,192,004.981	17,325,042.205	44,267
1960	2,949,714.776	1,344,969.885	18,929,787.096	45,409
1961	4,059,905.075	1,422,744.234	21,566,947.937	51,700

CANADIAN INCORPORATED N.R.O. MUTUAL FUNDS

PRIMARILY OWNED IN U.S.A.

	*	Net Value Assets at Market 1960	1959	1958	1957	1956	1955	Total Shares Outstanding 1960	1959	1958	1957	1956	1955
		- - - - - - - $ millions	- - - - - - -					- - - - - - - $ millions	- - - - - - -				
Axe Templeton Growth	1954	5.4	4.1	3.5	3.0	5.8	-	.62	.58	.55	.61	1.0	- (x)
Canada General Fund	1954	71.1	89.1	91.1	73.6	65.6	54.6	5.4	6.4	6.5	6.6	5.6	5.5
Cdn. Int. Growth	1956	11.1	10.2	6.5	4.5	-	-	1.1	1.0	.78	.73	-	-
Investors Group Cdn.	1954	111.9	144.2	167.4	120.3	107.9	51.6	21.1	25.7	29.3	27.9	19.1	10.2
Keystone Fund of Cda.	1954	15.3	16.3	14.6	12.6	8.8	6.4	1.1	1.3	1.2	1.2	.88	.71
N.Y. Capital Fund	1954	28.7	31.1	28.1	23.0	27.8	27.5	2.1	2.4	2.3	2.5	2.6	2.9 (x)
Scudder Fund Canada	1953	49.9	55.4	59.7	45.0	49.7	50.1	4.2	4.7	5.0	4.7	4.8	5.0 (x)
United Funds Canada	1954	15.9	18.5	23.3	19.1	20.7	14.4	.97	1.2	1.5	1.3	1.3	.99
		$309	$369	$394	$301	$286	$205	36.6	43.3	47.1	45.5	35.3	25.3

* Date of incorporation.
(x) Adjusted for stock splits.

Loomis-Sayles Fund of Canada Ltd. and U.B.S. Fund of Canada Ltd. have been omitted from the above tabulation because they are recent incorporations and would distort the overall figures.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX L

FINANCING OF SMALL BUSINESSES

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX L

FINANCING OF SMALL BUSINESSES

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APPENDIX L

FINDINGS OF THE COMMITTEE INVESTIGATING THE FINANCING OF SMALL BUSINESSES FOR THE INVESTMENT DEALERS' ASSOCIATION'S BRIEF TO THE ROYAL COMMISSION

DEFINITION

1) The sponsors of a worthwhile project requiring financing of $500,000 or more can generally make satisfactory arrangements for either a debt or equity issue with an established investment dealer. For the purposes of this study therefore, a small business is defined as one requiring to raise less than $500,000 regardless of the size of the business itself. Generally speaking a large business will not be looking for less than $500,000 through other than banking or regular mortgage channels.

WAYS OPEN TO A SMALL BUSINESS IN SECURING FINANCING

Private Placement

2) Friends and relatives of the entrepreneur who may take shares or bonused notes. This is the common approach for the very small enterprise and for the fortunate few having the right contacts. Private placements of both debt and equity can sometimes be arranged through investment dealers who will place the issue with a small group of clients or with one or two institutions selected from among the few willing to participate in financing of this type. Occasionally the members of the dealer firm will themselves participate if the issue particularly appeals to them or if it is a piece of interim financing before the company is ready for public offering.

3) Unfortunately, the record shows that few companies can qualify for this type of financing. In a recent survey made for the purposes of this study, 47 of the 103 Investment Dealers' Association members reporting had offered a total of 217 small business issues during the past two years. Of this number only 18 were for private placement.

Industrial Development Bank

4) This is Canada's best answer to date to the problem under study. At the end of its latest fiscal year the Bank had 1,364 loans outstanding for a total amount of $71,196,000 indicating an average outstanding balance of $52,000 per loan. Loans are only granted on the security of fixed assets.

5) In connection with the I.D.B. operations the following criticisms

were encountered:

i) Services too slow.

ii) Costs, which sometimes include bonus shares, may be too high as evidenced by the fact that reserves of some $18 million have been accumulated by the Bank.

iii) The lien on assets is often too tight or too wide to permit secondary financing.

iv) The required ratio of equity to the proposed loan may be too high.

v) The small business is often obliged to accept fixed obligations when equity capital may have been the proper route.

vi) Repayment requirements are often too heavy in the early years.

The Committee did not consider it incumbent upon it to investigate these criticisms and in general has felt that the operations of the I.D.B. were satisfactory.

Chartered Banks

6) This should be the first stop for the business requiring short term loans for such purposes as carrying inventory, accounts receivable, etc. This aspect is outside the scope of this study but it should be noted that inexperienced managements sometimes overlook this source of funds. Of particular importance are the bank loans available under the terms of the Small Business Loans Act. Manufacturing, wholesale trade, retail trade and service businesses grossing less than $250,000 per year may borrow up to $25,000 for certain kinds of equipment, fixed assets or improvements to fixed assets. The loan may cover up to 80% of the cost (90% on improvements to premises). The Government guarantees the lending bank to the extent of 10% of the aggregate of such loans granted by it prior to December 31st, 1963, but it is up to the bank to set its own standards as to security, credit risks, etc. It is probably because of this latter fact that loans granted under the terms of this Act have not been as numerous as originally expected.

7) The recent Throne Speech indicated that the current session of parliament would be asked to increase the size of such loans to $50,000

and extend eligibility to businesses with an annual gross revenue of $750,000. This move is strongly endorsed by this Committee. However, it is felt that an increase in the government guarantee to, say, 25% of the aggregate of all such loans granted by a lending bank and an extension of the 1963 deadline would widen the effectiveness of the Act.

Public Distribution

8) A canvass of a representative group of lending institutions confirmed their reluctance to participate in issues of small businesses. Almost without exception they avoid participation in small stock issues and their investments in small bond issues are very selective and limited. The investment dealer is accustomed to looking to these major pools of money for support in larger issues but the underwriter of smaller issues must rely on the retail buyer. This greatly increases the cost to the issuing company.

9) Large investment dealer firms with wide distribution powers cannot afford to handle small issues. However, the records show that if the issue has sufficient merit it is probable that an investment dealer can be found to take it on. As previously mentioned 47 I.D.A. members reported handling 217 such issues in the last two years. $200,000 appears to be the lower limit of practicability for public distribution although smaller issues are occasionally offered. Below this figure the costs are out of proportion and one or more of the major small business problems generally apply. These are

i) lack of management experience,

ii) lack of management depth,

iii) inability to withstand a recession,

iv) lack of marketability for the publicly held security,

v) reluctance to accept partners on equal or near equal basis,

vi) insufficient amount at risk by the owner or promotor.

10) The question of marketability is most difficult and is the objection most frequently cited by institutions and private investors alike. It strikes hardest against equity issues for obvious reasons and applies even in the case of successful operations.

Other Sources of Funds

11) There exist a few public and private organizations willing to

supply funds under certain conditions. Certain Municipal Industrial Commissions make funds available to small as well as large businesses by way of grants of land, commutation of taxes, etc. In Nova Scotia, the provincial government corporation, Industrial Estates Limited, will assist in financing the acquisition of land and buildings. Its existence has proved helpful on many occasions and has undoubtedly benefited the province. However, it does nothing to solve the equity problem. Certain private corporations are prepared to help with equity but they are ultra selective and they have only limited funds. It is felt that in general they are inclined to end up with too large a share of the common stock. Moreover such organizations are often unknown to the small management seeking financing. The factoring and acceptance companies are not a source of long term money.

METHODS IN BRITAIN AND THE U.S.

12) The Industrial and Commercial Finance Corporation was set up in 1946 by the Bank of England, the London clearing banks and the Scottish banks, to provide credit for industrial and commercial businesses or enterprises in Great Britain, particularly in cases where the existing facilities provided by banking institutions and underwriters and stock exchanges were not readily or easily available. This Corporation, as in the case of the small business investment companies, was thus intended to supplement but not supersede the activities of other lenders and other financial institutions. The Industrial and Commercial Finance Corporation considers that requirements of credit for small sums (under £5,000) can be made by the banks and that larger capital requirements (over £200,000) can be satisfied by the new issue market and other credit institutions and the Corporation is precluded from taking up either the whole or part of any loan of more than £200,000. The Corporation's nominal capital was fixed at £15,000,000 and all the shares are to be held by the banks which set up the Corporation which, in addition, may borrow from the shareholding banks up to twice the amount of its capital. It is not permitted to raise money from any other source than from the shareholding banks. It would seem that the shareholding banks in Great Britain now agree that the Industrial and Commercial Finance Corporation has earned itself a permanent place in the monetary system.

13) In the United States the Small Business Administration, set up by

the United States Congress in 1958, has contributed in a very major fashion in providing funds for small business ventures. Congress, after completion of a study by the Federal Reserve which established that long term funds were not easily available, passed a law authorizing the Small Business Administration to licence, supervise and, in certain cases, help finance small business investment companies which would serve as sources of equity capital and long term loans to small business. While there have always been individuals and businesses ready to invest in promising situations, the Small Business Administration served to institutionalize the procurement of venture capital for small business and make the rules for such procurement open for public scrutiny, very much as investment dealers and major stock exchanges have done for bigger business both here and in the united States. The success of the program established by the Small Business Administration is indicated by the fact that there are in existence some 425 small business investment companies with capital available for investment in small business amounting to $500,000,000. In addition to that sum, these small business investment companies may borrow from the S.B.A. 50% of that figure (subject to a limit of $4,000,000 each). This greatly increases their available funds and they may still borrow from outside sources. It might be noted that amongst the principal stock holders of many of these small business investment companies are more than 125 American banks, including some of the largest in the country. Small business investment companies also enjoy favourable tax advantages commensurate with the development work which they are carrying on.

14) The vast majority of these companies have been successful but some have not. However, sufficient experience has been gained to indicate the weaknesses of the system and this committee feels that a study of the S.B.A. with a view to adapting it to Canadian requirements is warranted.

CONCLUSIONS AND RECOMMENDATIONS

15) (Ia) If a small business has merit and mortgageable assets a persevering and informed management can probably arrange for debt financing through direct mortgage to a lending institution, the Industrial Development Bank, the Small Business Loans Act or, if not too small, public and occasionally private Placement through an investment dealer.

(Ib) All of these facilities tend to drive companies into borrowing when permanent equity capital may be the proper route for them.

(II) The largest pools of money, the banks and insurance companies, are of little help in long term financing for small businesses even those having mortgageable assets and a long earnings record.

(III) The majority of investment dealers can do little for the business requiring less than $200,000 and only certain firms will handle anything under $500,000. Lack of marketability makes public equity financing particularly difficult.

(IV) The low corporation tax rate applicable to the first $35,000 of earnings is particularly helpful to small businesses as it enables them to generate more funds internally and also makes them more attractive to potential investors.

(V) The operations of the Small Business Administration in the United States are worthy of careful study and consideration should be given to establishing similar legislation here which would result in small business investment companies having similar government support.

(VI) Consideration should be given to encouraging the participation of insurance companies, mutual funds and possibly the banks in equity investments in small business investment companies. These large lending investment institutions control tremendous funds practically none of which are at present available either for risk capital or for small business equity investment. If, for example, the life insurance companies were to apply for an amount equal to 1/4 of 1% of their portfolios to such investments, the proposed small business investment companies would have some $20 million of equity capital for their initial operations.

Representatives of certain I.D.A. member firms, with whom this committee consulted, did not agree that these aims should be achieved by legislation. The committee believes that better results could be obtained through encouraging these institutions to attack this problem voluntarily using the methods best suited to their individual circumstances and responsibilities.

(VII) To encourage public participation in the proposed small business investment companies special tax advantages should be considered. One such could be an increase in the present income tax credit from 20% to

30% for dividends from small business investment companies' shares.

(VIII) Many small entrepreneurs are reluctant to give up much equity. Consideration could be given by appropriate government authority to allow a tax credit, similar to that now made on dividends of Canadian companies, to corporate lenders who may loan money to small businesses or to individual lenders except when they are the owner of the business.

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX M

NON-RESIDENT INVESTMENT

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX M

NON-RESIDENT INVESTMENT

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NON-RESIDENT INVESTMENT

Introduction

1. The following brief outlines the role of non-resident investment in Canada, with particular emphasis on fixed monetary claims represented by debt. The factors which determine the composition and extent of purchases of debt securities by non-residents are outlined below:

General

2. Periods of great economic expansion in Canada have, in the past, brought foreign capital to this country. The most recent period of expansion, namely between 1946 - 1960, is the one we are particularly interested in, and is by far the greatest. Gross national product rose from $11,850,000,000 in 1946 to $34,857,000,000 in 1959. Foreign long term investment in Canada rose from $7.1 billion in 1945 to $20.6 billion in 1959.

3. While in earlier periods of expansion, capital came mostly from England and France, the United States has recently been by far the largest supplier of capital. In 1959 the total value of United States investments in Canada was divided as follows:

Direct Investment	$9,850 million
Government and Municipal	2,767 million
Other Portfolio	2,238 million
Miscellaneous	870 million
	$15,725 million

This compares with the total of
$20.6 billion from all countries

4. The growth of gross national product, gross capital formation and the extent to which this was financed from domestic and foreign resources is shown in Exhibit 1, appended hereto.

5. From 1946 to 1949 Canada raised at home sufficient capital to finance its gross capital formation and, in fact, was a net exporter of capital. In the subsequent years, foreign capital was imported in extremely large amounts and in 1959 over 29% of the gross capital formation was financed by the use of foreign resources. In 1960 and 1961 this capital inflow was substantially reduced.

6. Foreign capital has come to Canada in two main forms:

(a) Direct Investment
(b) Security or Portfolio Investment

Direct Investment

7. Direct investment involves the establishment of branch manufacturing plants by foreign companies, foreign purchase of established companies, direct foreign development of natural resources and construction of buildings of all kinds, etc. This particular kind of investment is almost entirely outside the field of the investment dealer but the amount of new capital invested in Canada in this way accounts for approximately two-thirds of all foreign investments. In many instances this capital has been accompanied by new techniques and has, consequently, developed resources in Canada that otherwise would never have been developed.

8. At the same time, direct foreign control has caused problems for Canada, particularly in the area of secondary manufacturing.

9. Canadian commercial policy has historically manifested itself in tariffs designed to provide a measure of protection for secondary manufacturing. This protection has encouraged United States companies to "jump" Canadian tariff walls and establish branch plant operations in Canada. In recent years, Canadian manufacturing has suffered from a large number of small firms operating in a limited market, resulting in excess capacity and high unit costs.

10. Exhibit 2 shows the amount of direct investment each year from 1946 to 1961.

Security or Portfolio Investments

11. The extent of sales of Canadian securities to non-residents is shown in Exhibit 2 and Exhibit 4.

12. The flow of capital to Canada through security or portfolio investments did not just happen. The investment dealer, with his knowledge of the huge demand for capital went out to foreign countries and sold investment opportunities in Canada to foreigners. Branches were established in foreign countries, mainly New York City and London, England and dealers directly contacted foreign institutional accounts. The investment dealer was so successful in selling Canada that Canadian portfolio securities became an established medium of investment.

13. The extent to which Canada benefited from this inflow of capital can be visualized to some degree by reviewing some of the major projects that were, at least partly, made possible by these funds:

(a) the construction of all the large pipelines, including gathering systems, to transport oil and gas from the mid-western fields to the eastern and Pacific markets,

(b) the development of iron mines in Quebec and Labrador and the construction of railroads into these areas,

(c) the Kitimat development of the Aluminum Co. of Canada,

(d) the huge hydro projects in most of the Provinces, but particularly those in Ontario and Quebec,

(e) construction of schools, hospitals, roads and subways by the major cities in Canada.

14. The investment dealers performed an important function in financing these developments by selling securities to non-residents when this capital was required.

15. External sales of new issues of Provincial, Municipal and Corporate debt securities in the period 1956 - 1960 amounted to $2,861,000,000.

Type of Security Sold in the United States

16. There are three main types of securities sold in the United States:

(a) United States payment bonds and debentures of Provinces, Municipalities and Corporations,

(b) Canadian payment bonds and debentures,

(c) Stocks.

United States Payment Bonds and Debentures

17. The type of security sold in the United States that produced the main source of capital funds was United States payment debt securities created for that market. Between 1954 and 1959 United States investors increased their holdings of Canadian debt securities, payable externally, by $1,469,000,000 as compared to $301 million in securities payable in Canadian funds only. In addition to being payable in the United States these securities were free from all Canadian taxes. In most instances they were made legal for investment of insurance companies and other institutions, were rated by the various statistical services and were issued for a term and with callable features attractive to the market. The yield return was also favourable in relation to comparable securities issued in the foreign market.

Canada Payment Securities

18. These securities were issued mainly for the Canadian market but

were purchased by non-residents when the Canadian market and the exchange rate made the yield return particularly attractive. Canadian payment bonds and debentures are not nearly as acceptable in the United States as securities payable in that country. Many institutions are unable to buy them under the laws of the various states and in addition, the buyer is required to take an exchange risk which he would ordinarily avoid.

19. Canadian Government and Guaranteed bonds of Canada were, until 1960 the only internal bonds free from Canadian withholding taxes and these securities were at times purchased extensively by non-residents.

Stocks

20. Although the sales of stocks to foreign countries are included in our tables as part of the trade with non-residents, Appendix J deals with this subject.

Main Purchasers of Securities in the United States

21. The main purchasers of Canadian debt securities in recent years are:

Life Insurance Companies
Pension Funds - both government and industrial
Savings Banks
Trust Departments of Banks
Charitable and Educational Funds

22. All non-resident insurance companies that write insurance in Canada are required to maintain in Canada a deposit of securities equal to their liabilities in Canada. Investment dealers, in many cases, sell securities to these companies for this purpose by direct calls to the Head Office of the company in the United States. The volume of securities sold for this purpose is substantial but in practically all instances, the actual money invested is generated by these companies in Canada and is part of the total savings of Canadians and does not affect our balance of payments position.

Comments on the Importance of Certain Factors on the Trade in Canadian Securities with Foreigners.

Exchange Rates

23. The yearly high and low value of the United States dollar in Canada between 1951 and 1961 is shown in Exhibit 3.

24. The greatest flow of capital to Canada took place when the Canadian dollar was at a substantial premium. This would appear to indicate that the exchange value of the Canadian dollar was mainly the result rather than the cause of the capital flow.

25. In 1950 and early 1951 the United States dollar was at a fixed premium of approximately 10%. At that time there was a good deal of speculation that the Canadian dollar would advance in price and foreigners bought large quantities of Canadian securities. The change to a free rate in 1951 was definitely influenced by the capital movement.

26. In June 1961, the Government announced its intention of taking action to move the value of the Canadian dollar to its "appropriate" level. The value of the Canadian dollar immediately started to decline and recently has fluctuated between a 3 - 5% discount.

Relative Yields

27. In the attached Exhibit 3, we show the spread in yield which exists between a particular Canadian Government security in Canada and a comparable United States Government security in the United States. Yields on Canadian long term Government bonds have always been higher than comparable United States issues from 1950 onward. As a result, Canadian issuers were able to sell securities payable in United States funds in the United States at yield rates which appeared to be more attractive than comparable rates in Canada. In fact, this condition exists today but mainly because of Government persuasion, Canadian issuers are confining their offerings to the Canadian market. (See Exhibit 5)

28. It is interesting to note as well that since 1950, the year 1955 was the only year in which Canada actually repatriated more of its securities abroad than it sold abroad and this was the year in which the spread in yield in favour of Canadian securities got to a relatively low level.

29. It should also be pointed out that yields on debt securities were probably lower in Canada between 1950 and 1959 than they would have ordinarily been because of the large volume of security sales in the United States.

Legislation and Tax Factors

Legislation in the Foreign Country

30. It is only in recent years that various States in the United States have made certain Canadian securities legal for the investment of insurance companies, banks and other funds. The ability to sell large quantities of securities in the United States depends on the extent to which they are legal for such institutions.

Legislation in Canada

31. In the period from 1951 to 1959 Canadian laws favoured foreign investors. External payment Canadian bonds and Canadian Government internal bonds were free of all Canadian withholding taxes.

32. In late 1960 and subsequently, certain actions were taken pertaining to Government policy that curtailed foreign sales of securities.

33. These included:

(a) The suggestion by inference in the budget speech of December 1960 that Canadian borrowers finance their requirements in Canada,

(b) The exemption from Canadian withholding taxes was withdrawn from external payment and Canadian government internal bonds, issued after December 1960,

(c) The Government policy to reduce the foreign exchange value of the Canadian dollar.

34. Some other events that caused uneasiness amongst foreign investors and indirectly reduced sales were:

(a) Federal Budgetary deficits,

(b) Controversy over the Governor of the Bank of Canada,

(c) The manner in which the British Columbia Electric Company was acquired by the Province of British Columbia.

35. The Government suggestion that Canadian borrowers finance their requirements in Canada was particularly effective in reducing sales because since that time there have been practically no new issues of foreign payment bonds sold by the Provinces or Municipalities.

36. The imposition of the withholding tax on external payment bonds could be having, and will have, a great effect on the volume of sales to non-residents. Among the largest buyers by volume of the highest grade external payment bonds in the past have been government and industrial pension funds, savings banks and fraternal organizations. These institutions pay little or no tax in their own country but they are not exempt from the Canadian withholding tax. The burden of this withholding tax would reduce substantially the yield return on new issues of Canadian securities and, as a consequence, these institutions are no longer buyers of Canadian securities that are subject to this tax.

37. It is probably too early for statistics to show the long term effect that these factors will have on foreign investment but net sales of securities were substantially reduced in 1960 and 1961. In addition, there was

a marked change in the category of investment. Foreign direct investment in Canada produced substantially more capital than net sales of securities. In the period 1956 to 1959 the opposite was the case.

Conclusion:

38. In the years of great expansion in Canada when the savings of the country were insufficient to provide the necessary capital and Canadian industry the capital goods, the investment industry went outside the country and sold securities to foreigners. It was shown that Canada had a good climate for foreign investment because of the character of the people, the sound Government policies and generally favourable economic conditions which indicated substantial growth.

39. As a result, foreign legislative bodies approved of and institutions accepted Canadian securities that were designed for the various markets and indicated their willingness to buy on a continuing basis. There is no doubt that the funds provided, increased the standard of living and wealth and the continuance of a flow of funds to Canada for productive purposes would undoubtedly create more wealth.

40. In the last two years at least, partly because of government legislation and action, the net inflow of foreign capital has been reduced. Nevertheless, the post-war trend of an increase in the relative importance of equity as against debt, reflecting the increase of direct investment has been intensified, carrying with it greater foreign ownership and control of Canadian business.

41. We are in accord with the policy that Canada should use its domestic resources to finance capital formation by using its own plant and labour to the utmost, providing at the same time, the standard of living of the population is being increased to the greatest extent possible.

42. As long as Canada continues to have a deficit of international payments on current account, funds must be provided from foreign sources.

Recommendations

43. Financial policy in Canada should be directed towards the following:-

> To the extent that it is necessary or desirable to import capital from foreign countries, Government policy should be such that it favours the purchase by foreigners of debt securities rather than equity investments of all kinds.

44. If effectively pursued, such policies would contribute to an increasing Canadian participation in our economic development and to a growing ownership of this nation's industry and resources.

* * * * *

Exhibit 1

GROSS NATIONAL PRODUCT
and
USE OF DOMESTIC AND FOREIGN RESOURCES
in
GROSS CAPITAL FORMATION IN CANADA

Year	G.N.P. at Market Prices	Gross Capital Formation	% of G.N.P.	Net Use of Domestic Resources	Net Use of Foreign Resources	Foreign Resources as % of Gross Capital Formation
	(Dollar amounts expressed in billions)					
1946	$ 11.85	$ 2.0	16.9%	$ 2.2	$ -.2	- %
1947	13.17	2.8	21.3	2.6	.2	7.1
1948	15.12	3.2	21.2	3.3	-.1	-
1949	16.34	3.6	22.0	3.5	.1	2.8
1950	18.01	4.5	25.0	3.8	.6	13.3
1951	21.17	5.7	26.9	4.8	.9	15.8
1952	24.00	6.0	25.0	5.6	.4	6.7
1953	25.02	6.6	26.4	5.4	1.2	18.2
1954	24.87	5.6	22.5	4.4	1.2	21.4
1955	27.13	6.6	24.3	4.9	1.7	25.8
1956	30.59	9.1	29.7	6.7	2.4	26.4
1957	31.91	8.9	27.9	6.3	2.6	29.2
1958	32.87	8.0	24.3	6.0	2.0	25.0
1959	34.86	8.7	25.0	6.2	2.6	29.9
1960	35.96	8.5 p	23.6	6.3	2.2 p	25.9

p - preliminary

Source: - Dominion Bureau of Statistics: 67-201

Population Census of Canada
as at June 1st

1951	....	14,009,429
1956	....	16,080,791
1961	....	18,238,247

* * * * * * * *

Exhibit 2

SELECTED NON-RESIDENT CAPITAL TRANSACTIONS
and
CURRENT ACCOUNT BALANCES FOR CANADA

1946 - 1961

(millions of dollars)

Year	Canadian Current Account Balance of International Payments (1)	Foreign Direct Investment in Canada	Net New Issues of Canadian Securities	Net Increase in Foreign Holdings of Canadian Portfolio Securities	As % of Net New Issues
1946	+ 363	40	28	- 127	--
1947	+ 49	61	- 84	- 282	--
1948	+ 451	71	168	39	23.2
1949	+ 177	94	64	- 34	--
1950	- 334	222	388	255	65.7
1951	- 517	309	157	265	168.8
1952	+ 164	346	976	133	13.6
1953	- 443	426	983	158	16.1
1954	- 432	392	972	191	19.7
1955	- 698	417	1849	- 45	--
1956	- 1366	583	1588	725	45.7
1957	- 1455	514	2279	757	33.2
1958	- 1131	420	3048	607	19.9
1959	- 1504	550	2281	650	28.5
1960	- 1217 p	645 p	1964	246	12.5
1961	- 989 p	420 p		303	

Notes: (1) + indicates surplus
- indicates deficit

(2) See Exhibit 4 for detailed account of transactions for years 1956 to 1961.

p preliminary

Sources: Dominion Bureau of Statistics 67-201
Bank of Canada Statistical Summary

Exhibit 3

COMPARISON OF YIELDS
ON
SELECTED CANADIAN AND UNITED STATES GOVERNMENT SECURITIES
IN CURRENCY OF PAYMENT

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
Govt. of Canada 2 3/4% Jan. 15. 1967/68 (1)											
(a) High	3.48	3.63	3.63	3.59	3.42	4.01	4.81	4.52	5.37	5.55	4.75
Low	2.98	3.47	3.47	2.92	2.81	3.24	3.66	3.31	4.45	4.09	4.12
U. S. Govt. 2 1/2% Dec. 15, 1963/68											
(a) High	2.71	2.73	2.73	2.66	2.98	3.49	3.93	3.94	4.90	4.97	4.20
Low	2.31	2.53	2.53	2.33	2.60	2.78	2.99	2.66	3.80	3.46	3.53
Yield Spread in Favour of Canadian Issue											
(b) Maximum Spread	.57	1.03	1.01	.99	.58	.66	1.06	.87	.99	1.13	1.18
Minimum Spread	.44	.76	.58	.40	.01	.35	.33	- .09 (2)	.34	.23	.07
Govt. of Canada 3 1/4% Oct. 1, 1979 (1)											
(a) High				3.26	3.44	3.90	4.35	4.42	5.30	5.42	5.20
Low				3.22	3.13	3.30	3.79	3.78	4.41	4.63	4.77
U. S. Govt. 3 1/4% June 15, 1978/83											
(a) High				2.93	3.01	3.39	3.71	3.88	4.41	4.48	4.11
Low				2.58	2.71	2.88	3.22	3.06	3.84	3.70	3.70

- continued

Exhibit 3 - continued

	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
Yield Spread in Favour of Canadian Issue											
(b) Maximum Spread				.61	.57	.59	.94	.79	1.20	1.39	1.41
Minimum Spread				.56	.22	.36	.36	.25	.50	.87	.73
Exchange Value of U.S. Dollar in Cdn. Currency											
High	7 5/16P	1 1/8P	7/32D	1 1/4D	1/16P	1/32D	1 3/8D	27/32D	1 13/16D	3/16D	4 3/8P
Low	1 3/16P	4 1/8D	3 1/8D	3 21/32D	3 17/32D	4 11/32D	5 25/32D	4 1/4D	5 7/16D	5 1/16D	1 3/4D

Notes: (1) Payable in Canadian currency
(2) On September 3rd, Cda's. 2 3/4/68 yielded 3.59% as against 3.68% for U. S. 2 1/2/68

Source: Compiled by the Investment Dealers' Association of Canada from figures extracted from Bank of Canada Statistical Summary.

(a) Figures shown for years 1951-53 are from closing mid-market quotes for the middle Wednesday of each month, from which quotes the above highs and lows have been taken. Figures for 1954 and subsequent years are compiled from closing mid-market quotes each Wednesday of the year.

(b) The figures for yield spreads are calculated from the same sources as were used in (a) but represent the maximum and minimum spread in yield between the prices quoted for the two securities on any given Wednesday, without reference to the high or low points in actual yields.

* * * * * * * *

NON-RESIDENT TRANSACTIONS IN CANADIAN SECURITIES

1956 - 1961

Year	Category (1)	Net Transactions in Outstanding Securities	Sales of New Issues to Non-Residents	Retirements of Foreign-Held Securities	Net Capital Inflow from Transactions
		($ millions)			
1956	Government	6	9	83	- 68
	Provincial	- 11	224	15	198
	Municipal	2	112	18	96
	Corporate	14	252	20	246
	Total Bonds	11	597	136	472
	Stocks	188	70	5	253
	Total Securities	199	667	141	725
1957	Government	- 14	16	29	- 27
	Provincial	- 15	136	25	96
	Municipal	- 1	123	24	98
	Corporate	- 15	462	30	417
	Total Bonds	- 45	737	108	584
	Stocks	137	61	25	173
	Total Securities	92	798	133	757
1958	Government	20	76	25	71
	Provincial	- 18	168	45	105
	Municipal	- 1	148	30	117
	Corporate	- 1	242	42	199
	Total Bonds	-0-	634	142	492
	Stocks	88	43	16	115
	Total Securities	88	677	158	607
1959	Government	118	56	101	73
	Provincial	- 5	334	41	288
	Municipal	2	158	34	126
	Corporate	- 24	112	65	23
	Total Bonds	91	660	241	510
	Stocks	110	47	17	140
	Total Securities	201	707	258	650
1960	Government	49	31	58	22
	Provincial	- 8	102	51	43
	Municipal	4	135	35	104
	Corporate	- 42	153	100	11
	Total Bonds	3	421	244	180
	Stocks	49	26	9	66
	Total Securities	52	447	253	246

... continued

Exhibit 4 - continued

Year	Category (1)	Net Transactions in Outstanding Securities	Sales of New Issues to Non-Residents	Retirements of Foreign-Held Securities	Net Capital Inflow from Transaction
		($ millions)			
1961	Government	75	37	47	65
	Provincial	- 8	53	23	22
	Municipal	3	36	40	- 1
	Corporate	- 7	330	129	194
	Total Bonds	63	456	239	280
	Stocks	40	36	53	23
	Total Securities	103	492	292	303

Notes: (1) Bonds and Debentures include direct and guaranteed issues in each category

Source: Dominion Bureau of Statistics 67-201 and 67-002

* * * * * * * * * *

Exhibit 5

QUOTATIONS ON CANADIAN PROVINCIAL AND MUNICIPAL SECURITIES
IN CANADA AND THE UNITED STATES
(March 12th, 1962)

Market Quotations in United States on Securities Payable in United States Funds	Price	Yield	Market Quotations in Canada on Securities Payable in Canadian Funds	Price	Yield
* Province of Ontario 4 3/4% Bonds Due 1st February 1984	102 1/2	4.57%	Province of Ontario 5 1/4% Bonds Due 15th March 1982	100 3/8	5.22%
* Quebec Hydro-Electric Comm. 5% Bonds Due 15th July 1984	105 1/2	4.60%	Province of Quebec 5 1/4% Bonds Due 1st April 1984	99 5/8	5.30%
* Metropolitan Toronto 5% Bonds Due 1st June 1979	105	4.58%	Metropolitan Toronto 5 1/2% Bonds Due 15th February 1982	101 1/2	5.38%

United States Funds quoted in Canadian dollars
@ 4 7/8% -- 4 15/16% Premium

* Issued prior to December 1960

BRIEF TO THE ROYAL COMMISSION ON BANKING AND FINANCE

APPENDIX N

TAXATION

Submitted by

THE INVESTMENT DEALERS' ASSOCIATION OF CANADA

APPENDIX N

TAXATION

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The Taxation portion of the Brief
submitted by
The Investment Dealers' Association of Canada

Introduction

1. In a complex and industrialized economy such as we have in Canada, taxes are recognized as a major factor and instrument of economic policy. To indicate the importance of taxes, government revenue at all levels for 1960 represented approximately 28.7% of Canada's gross national product, and of this, taxes provided about 82% (see Exhibit A).

2. Government taxing and spending now occupies a prominent position on the economic landscape for a variety of reasons, and expenditures by governments at all levels have increased very greatly compared to the pre World War II era, most of such increase having taken place during a period of unprecedented economic expansion. Such spending, perhaps some of which has been made for reasons hinging more on political expediency than on actual need, has had to be financed by increased revenues. To be more specific, in 1939 government revenue at all levels represented approximately 20% of Canada's gross national product in such year, compared to the present level of about 29%. On a percentage basis this is an increase of nearly 50%. Furthermore, this percentage increase relates to a very greatly increased gross national product. On a dollar basis the increase is very much greater, the total revenue for 1939 by governments at all levels being approximately $1,110,000,000, compared to the figure for 1960 of $10,306,000,000. In other words, on a dollar basis, the present requirement by governments at all levels is nearly ten times that of 1939. Expressed on a per capita basis, total revenue for 1939 by governments at all levels averaged approximately $95 per person for the population in such year, but by 1960 this had risen to a figure of $560 per person; an increase of nearly 500%. In all years studied, taxes provided in excess of 80% of government revenue (see Exhibit A). Only by a reduction in government spending can taxes, the principal source of government revenue, be realistically and permanently reduced.

3. It is against this background of increased government spending and the present means of financing this spending, relying as it does largely upon our taxation structure, that we believe the tax policies currently existing in Canada must be critically examined.

4. The growth of an economy depends on an increasing demand for goods produced and services rendered. The willingness of consumers, businesses and governments to spend money for goods and services, leads to utilization of capacity or expansion of such capacity. Conversely, lack of spending leads, not only to reduced utilization of capacity, but to unemployment of individuals. This in turn fosters the trend towards state socialism, requiring greater expenditure by government for purposes that may tend to be unproductive.

5. To adjust for the fluctuations caused by either over-utilization or under-utilization of capacity, present day economic thinking seems to have accepted the principle that governments, either directly or through controlled indirect operations (such as a Central Bank) should endeavour to alleviate such fluctuations. In an attempt to mildly suppress the economy during boom periods, spending is discouraged by government, and to strengthen the economy during recession periods, spending is encouraged. We consider it desirable that governments, with moderation, use periods of economic expansion to reduce debt and generally strengthen the economic framework of the country in preparation for periods of recession, when deficit and debt financing may become necessary.

6. Today, the heavy tax "load", and the method of application of such taxes, is having a profound affect on our economy, and the appeal being heard from many sources (see Exhibit B) for a thorough examination of Canada's taxation system is most appropriate. It is particularly so in relation to the problem of using fiscal policy as an aid in regulating the severity of business cycles. It is even possible that,of the various alternatives open to government to raise money now required for public spending, a tax levied upon income, as opposed to other means of producing revenue, may be a less than satisfactory method and in many respects may be undesirable.

<u>Basic Principles and Areas for Examination</u>

7. Without restricting the area of study of our taxation system, we wish to express an opinion on some of the basic principles that need to be examined in any major tax study. These basic principles and the areas in need of study are as follows:

i A general simplification of the total taxation system which would result in a greater understanding of its operation along with increased ease of collection.

ii A more equitable distribution of the tax load than is currently the case.

iii Increasing use of indirect taxation in order to broaden the tax base.

iv Greater use of the incentive approach in order to direct economic activity and individual endeavour, and to funnel savings into revenue and employment producing activities.

v An examination and study of the taxation systems and practices of certain other countries that are experiencing problems similar to those currently being experienced in Canada in order to see how such problems have been met by other countries.

vi A detailed study of the problems currently relating to various types of corporate surplus.

vii The effects of double taxation, particularly as it relates to corporate dividends.

viii The effect of the current tax structure on the types of financing being carried out by Canadian corporations.

ix Examination of the division between capital gains and income in order to define and differentiate more clearly between the two.

x The ability of a taxpayer to obtain a tax ruling prior to a transaction, as is possible in other countries.

xi The elimination of the current tax disadvantages to Canadian individuals in the development of oil and other natural resources as compared to the position of individuals in the United States operating in Canada.

xii Finally, it is important that a tax system be evolved to encourage, as much as possible, the orderly development and expansion of the Canadian economy for the benefit of all Canadians.

Taxation Studies Currently in Progress

8. We fully appreciate the long and arduous task involved in any major study of the existing Canadian tax structure and for this reason we believe that those undertaking any such study should avail themselves of prior studies on taxation in Canada.

9. At the present time Queen's University, Kingston, sponsored by the Canadian Tax Foundation, is in the process of carrying out a study of the level and structure of taxation in Canada, emphasizing the effects of changes in taxation on the economic growth of Canada. This study is to be completed not later than September 30, 1964.

10. The scope of the Queen's University study is extremely broad and encompasses many, although by no means all, of the areas that we believe should be examined, and we suggest that the results of this particular study on taxation should be carefully considered.

The Need for a Comprehensive Study of the Canadian Tax Structure

11. It is our opinion that a complete investigation of the working of the Canadian tax structure today is essential in order to provide the proper emphasis on the direction in which the Canadian economy should be moving in a world environment which is now so different to that which existed prior to World War II. To indicate this change, at the present time approximately 56% of Canadian exports (by dollar volume) are now being made to the United States as compared to only about 33% prior to World War II. In this same period exports to Great Britain declined to approximately 17% from over 40% of the total (see Exhibit C). These fundamental and basic changes would in themselves, we believe, warrant a detailed investigation of the present Canadian tax system.

12. In addition, recognition of the trend towards the formation of large economic blocks is of equal importance in judging the suitability of Canada's present tax structure. The United States represents one of these major blocks and, as a result of its proximity, its influence has been one of the major factors affecting the direction in which the Canadian economy has tended to move over the years. This influence may not be in the best long term interests of Canada. More recently the formation of the European Common Market represents the creation of another major block and, within a short period of time, the consolidation and forward momentum of this block may well affect Canada's exports to the countries forming this block.

13. In view of the above changes that have taken place and the possibility of greater changes in the near future, and as the present Canadian tax structure was formulated under conditions very different to those existing today, we respectfully submit that a thorough review of the Canadian tax structure is long overdue and is essential for continued Canadian prosperity.

General Comments and Factors Meriting Examination

Simplification of the Tax System

14. In our discussions with various tax authorities we have encountered the apparently general opinion that the Canadian tax structure, as it now stands, does not compare too unfavourably with the tax structures of other major industrialized countries with regard to simplicity and fairness to the individual. Nevertheless, in view of Canada's position in the world today, such a fact we believe does not state the case adequately and, in our opinion, taxes in Canada are high and not always easy to determine. The present patchwork of our tax laws is complicated and results in too much effort being utilized in tax avoidance. In connection with income, the thin line between ordinary income and capital gains is often the subject of confusion and dispute. While we appreciate that it may be difficult to avoid a complicated tax structure in a modern industrial state, we nevertheless believe a determined effort should be made to simplify the operation of the tax system as much as possible. The simpler the taxation system, the easier it will be for individuals and business to make decisions without undue emphasis being placed on the tax consequences. It will also be easier to collect taxes on an economical basis.

15. The complications resulting from the provisions of the Canadian Income Tax Act are frequently referred to as providing considerable employment to the legal and accounting professions.

A More Equitable Distribution of Taxes

16. In the relatively brief time available to us to examine the Canadian tax structure we have been impressed by the lack of incentive planning in the tax structure, along with the degree of discrimination that exists against certain segments of the productive population. Examples of inequities are to be found in the various forms of double taxation as

income is funnelled through corporate channels to the investor. Another much discussed and little understood example of inequitable distribution of the tax load is that of the agreement among a community of individuals, trading amongst each other, to reduce their net incomes (and, therefore, their taxable incomes) through the exchanges of goods and services at prices below the then current market prices. Examples of the formal organization of such groups or communities trading among themselves are the phenomena known in Canada as co-operatives or credit unions. Quite apart from whether or not these organizations qualify under the Income Tax Act as taxable or tax-exempt (and it has been widely thought that Co-operatives are not taxable whereas in fact most of them are taxable), the fact is that such organizations, by expressly reducing their taxable incomes and thereby failing to contribute their fair share of the tax load, illustrate another weakness in the fabric of our income tax structure.

17. It is our belief that a modest reduction in the higher marginal rates of personal taxation would be a constructive move and would increase personal incentive and initiative and would at the same time have an almost negligible effect on the revenue of the government. While of course there are always many exceptions, generally speaking we believe that such high marginal rates of personal taxation tend to stifle incentive for hard work and ideas. We question, for example, whether it is right and just for an individual taxpayer to be taxed at a higher rate than the largest Canadian corporations. The highest marginal rates of personal tax (which rise to as high as 80% at the top level) contribute little in relation to the total personal tax dollars collected. If, for instance, the highest rates of personal tax were limited to 50% (assuming all other rates were to remain as at present), the total loss of revenue to the government would be in the neighborhood of around $10,000,000, or substantially less than one per cent of the total personal tax collected. All present trends point to increased political demands on government at all levels to increase public spending for such collective goals as counter-cyclical fiscal policy, education and social welfare. It is obvious that an excessively high rate of income tax tends to decrease the enthusiasm of a high income earner for hard work. The productivity of such a high income earner tends, as a result, to decline as income rises.

18. In view of Canada's position, balanced between two huge economic blocks, it is our opinion that it is more important than ever before to encourage and foster within the country individuals having a high degree of ability and to assure that their financial rewards will be greater than is

currently the case. This is especially true in certain lines of endeavour, such as the professions and some segments of the service industries, where any material amount of compensation except through salary is essentially impossible.

Use of Indirect Taxation

19. We are of the opinion that serious consideration should be given to broadening the tax base. For the year 1959, of the approximately 4,200,000 personal income taxpayers in Canada, approximately 4,000,000 - or over 95% - paid less than the average rate that would have had to be levied against all taxable personal income in order to have collected the same amount of revenue. Such average rate of tax was approximately 17½% on taxable personal income assessed. The approximately 200,000 taxpayers (less than 5% of the total) who paid more than such average rate provided (for the year 1959) over $500,000,000 out of the total from all taxpayers of approximately $1,600,000,000. In other words, less than 5% of the taxpayers were required to pay more than 30% of the total personal income tax collected in order that more than 95% of personal income taxpayers could pay less than the average rate of tax (see Exhibit D).

20. If the revenues of the government are to be increased substantially, other than through increased receipts as a result of economic expansion, and without hampering the means by which growth is attained, then it is our belief that this will have to be carried out by broadening the tax base. One of the most practical methods of broadening the tax base is through a greater use of indirect taxation and we believe this approach deserves special investigation.

21. A higher sales tax and/or a sales luxury tax on all goods and services might be implemented to the end that both corporate income taxes and personal income taxes might be greatly reduced. It is our suggestion that such a sales tax would be easier and less costly to collect than the present system of income tax, due to being based on the act of a sale which is easily established. Further, a high sales tax concept would tend to encourage personal saving which would be available for investment in the development of Canada. Under the present personal income tax concept, personal savings are taxed.

22. With regard to the broadening of the tax base, we have also been impressed by the fact that many individuals and groups receive the fruits and benefits of Canadian expenditures, but do not pay their full share for these benefits, although they are well able to do so. For example, it appears to us that the present income tax structure is in many ways inadequately related to the important and financial power of institutional, mutual and other similar corporate entities, together with co-operative entities mentioned earlier, and such corporations may not at this time be bearing a fair proportion of the tax burden. In view of this possible loss of revenue to the government, which results in an added tax burden for other taxpayers, we believe a thorough study should be made of the special tax considerations currently enjoyed by certain corporate entities.

To Encourage Economic Activity Through the Use of Tax Incentives

23. Although all taxation is punitive and acts as a disincentive, nevertheless by varying the emphasis of the tax burden, economic activity and human endeavour can be encouraged to flow in certain directions considered to be desirable. This function of the taxation system in influencing economic objectives by providing direction is one which we believe requires much study. In the consideration of Canada's current and potential problems several areas are indicated where activity and effort might well be encouraged through a positive use of the tax structure to achieve and encourage a strong sense of direction. Particularly is there a need to increase Canadian exports, especially those of manufactured or semi-manufactured goods, and to encourage their distribution throughout a greater number of trading areas. Also of imminent concern is the need to provide for the employment of a labour force that is expanding at a rate considerably in excess of that at which it can be absorbed by existing industry. Neither of the above mentioned problems lend themselves to any easy solution but both require immediate attention. In our opinion, one method of applying the incentive necessary to encourage activity to move in the direction in which these problems can be solved, or at least alleviated, is through allowing industry to charge depreciation in excess of 100% under certain conditions. An incentive of fairly large proportions must be granted to industry to assure that movement in the desired direction actually will take place. We commend the thinking that under certain conditions industry might be permitted to charge depreciation of as much as 150% to 200% on certain of their assets.

In connection with the matter of depreciation, it is interesting to note that Canada continues to use the more complicated reducing balance method of depreciation, while Great Britain has reverted to the simpler straight line method. This we believe to be another area which requires study.

Comparison of Canada's Tax System to Other Countries

24. A number of countries, such as Australia, New Zealand, South Africa and the Scandinavian countries, to mention a few, have many of the same basic problems that affect Canada at the present time. In some of these countries, as in Canada, exports of a small number of primary natural resource commodities are extremely important from the point of view of over-all national prosperity. We believe that consideration should be given to the way in which these countries have adapted and orientated their tax structure in order to suit conditions which bear a high degree of similarity to conditions in Canada. These tax structures should also be examined to find out if and what tax incentives are provided to encourage the formation of a strong and prosperous secondary industry. Other countries, such as Sweden, are popularly known as "welfare states" and some examination should be made as to the financing of these welfare benefits. We have noted with interest that the Swedish government appears to be giving increased recognition to the need to broaden the tax base by the recent increase in their national retail sales tax. Mention has already been made herein of the desirability of broadening the tax base in Canada.

Tax Problems Related to Corporate Surplus

25. Problems relating to corporate taxation are in many respects more difficult of satisfactory solution than those relating to personal taxation. One of the major corporate tax problems existing today concerns the handling of the various types of corporate surplus for taxation purposes. We understand that a great deal of consideration has been given to this problem by the Department of Finance in Ottawa. While Section 95 and later Section 105 of the Income Tax Act gave some initial relief and encouraged surplus distribution, these sections are unfortunately now relatively cumbersome and ineffective. This has resulted in what we consider to be a wasteful expenditure of time and energy in legal manoeuvres

to avoid the current restrictions governing corporate surpluses. We do not wish to suggest that we have any solution for this highly complex problem but we do believe that it might be fruitful to pursue thinking which would result in a basic corporate tax at a fixed rate with a further flat tax being made at the corporate level on all distributions to shareholders, such distributions then being tax free in the hands of the shareholder. We have not been able to follow such a proposal through to its logical conclusion in order to assess all the effects that it would have throughout the economic system. However, it is our understanding that this type of tax is used in a number of countries and the results of its practical operation should be worthy of study.

The Effects of Double Taxation

26. The dividend tax credit is a most forward and progressive piece of fiscal thinking on the part of government. This legislation was originally passed for the purpose of relieving the effects of double taxation on the corporate dollar paid out in the form of dividends to shareholders. In 1953, when this dividend tax credit was increased to its present level of 20%, it was also stated that an additional purpose was to encourage Canadians to invest in Canadian equities.

27. While the dividend tax credit has gone a long way in relieving the effect of taxing twice the same corporate dollar paid out in dividends, the relief has nonetheless not been complete and it should be recognized that many shareholders continue to carry more than their fair share of the tax burden.

The Taxation Effect on Financing

28. The use of the dividend tax credit has been successful in encouraging Canadians to invest in Canadian equities as opposed to investing in foreign equities. However, such tax credit has had little apparent effect on encouraging corporations to finance through the issue of equity rather than debt securities, and if this is to be accomplished it would seem that some incentive will have to be given at the corporate level as well as to the shareholder.

Differentiation between Income and Capital Gains

29. Undoubtedly in any full study of the existing Canadian tax structure the question of the advisability of instituting a capital gains tax will arise. We have attempted to keep an open mind on this matter of the taxation of capital gains. Such a tax has been in operation in the United States for some years and currently a speculative gains tax is being considered in Great Britain. At the present time in Canada both the operations of business and of individuals are frequently made more difficult in that there are circumstances under which it is difficult to determine whether such operations are in the area of income or in that relating to capital gains. We realize that the differentiation between these two areas is frequently exceedingly difficult but a more precise definition of each would undoubtedly be of great assistance. We have found no support for a capital gains tax as it exists in the United States, nor do we support such a tax ourselves. Taxation of capital gains causes at times severe market dislocations, as individuals and corporations sell for the purpose of establishing capital losses to apply against capital profits. Such artificial effects on the market are not in the public interest. Furthermore, such a tax has the disadvantage of having a high cost of calculation and collection. The requirement of the Canadian economy for continuing and substantial growth in which ever increasing quantities of equity capital is essential indicates that any capital gains tax would be inadvisable and not in the best interests of Canada.

Advance Tax Rulings

30. In conjunction with the problem of differentiating between capital gains and income, as well as in connection with such other problems as those relating to corporate surpluses, we believe thorough study should be given to enabling a taxpayer to obtain a tax ruling prior to completion of a transaction. This is common practice in the United States and the adoption of such a policy in Canada would contribute greatly to the elimination of much of the present confusion involved in many business transactions.

The Elimination of Tax Disadvantages in Development of Canada's Natural Resources

31. The unfavourable position of individuals in Canada who are engaged in the exploration for oil and gas natural resources in Canada, as compared to the position of individuals in the United States operating in Canada, is well known and it is believed that numerous submissions have been made to the Department of Finance and the Income Tax Department relating to this unfavourable treatment. In effect the United States tax laws permit an individual to write off, against other taxable income, losses incurred in the development of such natural resources. The Canadian tax law does not permit the Canadian individual this type of write-off and it may well be due to this reason that such a high percentage of such Canadian natural resources are foreign controlled. While we do not agree or disagree with these laws as they are applied in the United States, the effect of the Canadian law has not been beneficial to Canada, and in fact we believe it to have been harmful.

32. Revision of the Tax System for the Orderly Growth of the Economy

Perhaps one of the most distressing of all the features that can be attributed to the present tax structure is that in a period when the need for fiscal controls as an aid in regulating the economy is pronounced, the use of our tax structure as a fiscal agent seems to be impractical from a political point of view. Governments have been prepared to raise taxes in boom years as a brake against inflationary pressures, but have been less prepared to lower taxes during periods of reduced economic activity. It seems likely that because of its lack of political popularity, such a fiscal weapon, effective as it might prove, will rarely ever be used properly or quickly enough, whether for the purpose of stimulation or suppression. The extensive use of indirect taxation would permit rapid controllable changes in our taxation system.

33. It has been our intention throughout this brief to point out numerous areas where we believe the current tax structure is hindering rather than promoting economic growth, and at the same time minimizing rather than maximizing government revenues. It has been impossible for us to ascertain in such a brief study where the solution to these problems lies. However, we do believe it essential that the tax structure be more closely linked with a national sense of direction and priorities.

Thus we contend that an effort must be made to find a positive approach to taxation that will accomplish far more than the negative approach which currently is employed.

34. In order that many of our suggestions may be carried out, a sweeping revision of the present Income Tax Act will be required. We appreciate that many problems will be created in accomplishing this, such as the time and expense in examining our Income Tax Act in its entirety, and the possible nullification of many established legal decisions. Nevertheless, in consideration of the impact taxes have on Canada's economy, it appears essential that competent personnel should carefully study, and recommend revision in, our tax laws so as to assist in the continued development of Canada.

Conclusions and Recommendations

35. Any review of the tax structure of a complex industrialized society requires a detailed appreciation of the impact that taxes have on the economy; on long term economic development; and even on the formation of social attitudes and national outlook. In the time available for the preparation of this brief it has been impossible to approach the subject of taxation in the detail and depth which is needed, and which in our opinion is urgently required. Therefore, we have tended to confine our study of taxation in Canada to those areas where we feel a revision of the existing tax structure would be of greatest benefit to all Canadians and to express our conclusions in relatively general terms.

1. In general, we have concluded as follows:

   i Greatly increased government spending in recent years has necessitated greatly increased taxation. The political inclination for increased government spending seems likely to continue. We question whether the income tax path and our income tax structure is the best available means of meeting such continuing need for increased revenues. — Paragraphs 1 to 6 inclusive

   ii There are twelve specific areas that we feel merit intensive study. In addition, the reports of other studies merit consideration. — Paragraphs 7 to 10 inclusive

iii	Changes in conditions, particularly Canada's position in the world economy, raise the question as to whether a revised tax structure would not better suit Canada's economic needs.	Paragraphs 11 to 13 inclusive
iv	The simplification of the tax system, if possible, would be very desirable.	Paragraphs 14 and 15
v	Inequities in the tax load suggest that the present income tax pattern is less than satisfactory and discourages incentive.	Paragraphs 16 to 18 inclusive
vi	Indirect taxation should receive consideration as an alternative or partial alternative to income tax.	Paragraphs 19 to 22 inclusive
vii	An incentive method of applying whatever taxation is necessary should receive more attention.	Paragraph 23
viii	Tax systems of other countries should be studied with a view to obtaining ideas for use in Canada.	Paragraph 24
ix	Tax on corporate surplus should be revised to prevent present inequities and unnecessary corporate manoeuvres.	Paragraph 25
x	The 20% tax credit has considerable merit but the further reduction of double taxation in its various forms should be studied.	Paragraphs 26 and 27
xi	Use of the dividend tax credit has provided little stimulus to corporate equity financing.	Paragraph 28
xii	The requirement of the Canadian economy for continuing and substantial growth in which ever increasing quantities of equity capital is essential indicates that any capital gains tax would be inadvisable and not in the best interests of Canada.	Paragraph 29

xiii The advantages of enabling a taxpayer to obtain a tax ruling prior to a transaction merit thorough study. — Paragraph 30

xiv Canadians are still at a disadvantage, compared to U. S. citizens and corporations, in respect to the development of their own oil and gas natural resources. — Paragraph 31

xv The use of the present tax structure as a fiscal control in the orderly growth of the economy has not been properly utilized. In this and other respects taxes must be more closely linked to a national sense of direction. — Paragraphs 32 to 34 inclusive

2. Specifically we recommend the following:

i In order to encourage a more rapid and sound development of the Canadian economy and to make more certain of its ability to absorb a rapidly increasing work force, we recommend the formation of a Select Committee to study and assess the entire tax structure of Canada with the objective of devising an improved taxation system better able to meet Canada's economic needs.

ii We further recommend that before holding public hearings such Select Committee should carry out its initial deliverations on a confidential basis at the highest level in order to arrive at some definite conclusions under objective conditions.

iii Furthermore, such Select Committee should be composed of highly qualified individuals having a broad working knowledge of the present tax structure with most emphasis being placed on its practical operation in business and in the economy as opposed to its legal and account operation. Such a Committee should be composed primarily of representatives of Business from members of The Canadian Chamber of Commerce and Boards of Trade, representatives of Finance from members of The Investment Dealers' Association of Canada and The Canadian Bankers' Association, practical economists, and representatives of the Canadian Tax Foundation, and secondarily of members of the Legal and Accounting professions.

EXHIBIT A

Total Government Revenue Expressed as a Percentage of

Gross National Product

For Selected Calendar Years, 1929 to 1960

Year	Total Government Revenue				Total Government Revenue as a Percentage of Gross National Product				Total Taxes (all Governments) as a Percentage of Gross National Product	Total Taxes (All Governments) as a Percentage of Government Revenues
	Federal	Provincial	Municipal	All Governments	Federal	Provincial	Municipal	All Governments		
	$mm	$mm	$mm	$mm	%	%	%	%	%	%
1929	399	200	366	965	6.5	3.3	6.0	15.7	13.1	83.4
1933	248	167	327	742	7.1	4.8	9.3	21.1	18.5	87.7
1939	459	295	356	1,110	8.1	5.2	6.3	19.7	16.7	84.8
1945	2,438	435	396	3,269	20.6	3.7	3.3	27.6	22.6	81.9
1946	2,602	519	417	3,538	22.0	4.4	3.5	29.9	24.9	83.3
1947	2,740	674	455	3,869	20.8	5.1	3.5	29.4	24.9	84.7
1948	2,677	812	511	4,000	17.7	5.4	3.4	26.5	22.1	83.4
1949	2,654	887	556	4,097	16.2	5.4	3.4	25.1	20.8	82.9
1950	2,965	978	624	4,567	16.5	5.4	3.5	25.4	21.0	82.7
1951	4,110	1,144	715	5,969	19.4	5.4	3.4	28.2	23.8	84.4
1952	4,626	1,136	809	6,571	19.3	4.7	3.4	27.4	23.0	83.9
1953	4,726	1,188	874	6,788	18.9	4.7	3.5	27.1	22.7	83.8
1954	4,528	1,246	945	6,719	18.2	5.0	3.8	27.0	22.3	82.6
1955	4,937	1,409	1,040	7,386	18.2	5.2	3.8	27.2	22.5	82.7
1956	5,578	1,598	1,163	8,339	18.2	5.2	3.8	27.3	22.6	82.8
1957	5,588	1,877	1,288	8,753	17.5	5.9	4.0	27.4	22.7	82.8
1958	5,321	1,979	1,416	8,716	16.2	6.0	4.3	26.5	21.7	81.9
1959	6,005	2,226	1,549	9,780	17.2	6.4	4.4	28.1	23.1	82.2
1960	6,280	2,354	1,672	10,306	17.5	6.5	4.6	28.7	23.4	81.5

Exclusive of inter-governmental transfers.

Includes Newfoundland for 1949 and subsequent years.

(All dollar figures stated in millions)

Source: NATIONAL ACCOUNTS, INCOME AND EXPENDITURE, D.B.S. (Dollar Figures Only).

May 1962

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EXHIBIT B

A few of the many comments by prominent Canadians on the Tax Structure

The high levels of taxation and the discouragement of incentive through the incidence of taxation impede the accumulation of risk-taking capital which will be necessary for our future growth.

Neil J. McKinnon
President, Canadian Imperial Bank of Commerce
December 12, 1961

There is, however, one aspect of our cost structure which will remain to plague us in spite of any progress we may make in our efforts to increase the efficiency of industry: I refer to our dis-incentive tax structure.

The burden of taxation lies not only in its absolute level, or even in its level relative to other countries, but in distortions induced by the uneven incidence of taxation. Greater incentive, and a greater national product, require a reform of our personal income tax, our corporate income tax, and our whole system of sales and excise taxes, with incentive as one, though by no means of course the only, object in view.

W. Earle McLaughlin
President, The Royal Bank of Canada
January 11, 1962

Counting all forms of taxes and exemptions, there is no question that the burden of taxation in Canada for the technical, professional and supervisory groups is far more onerous than elsewhere on this continent. Is it little wonder, therefore, that we continue to lose thousands of our best trained Canadian men and women to the United States and elsewhere, and are left with more and more untrained unemployables to look after. Unless there is more incentive for educated Canadians to stay here and for skilled outsiders to come to Canada and remain, it will be very difficult for us to have a buoyant and expanding economy. We shall lose the very people who could and would make Canada great. I suggest that this incentive should be provided by reducing our present tax loads so that they are definitely more favorable than elsewhere on this continent, and when we have done that we should live within our means. This, of course, implies that we should give much careful study and consideration to our present heavy burden of welfare costs and subsidies before increasing present commitments or embarking on new programs, as desirable as many of them seem to be.

E. G. Burton
Chairman and President, Simpsons, Limited
April 25, 1962

EXHIBIT B

(continued)

Not only is there a need to restrain further increases in the already heavy tax burden, but a complete overhaul of our taxing systems is long overdue and I feel that this should be undertaken without delay.

V. W. Scully
President, The Steel Company of Canada, Limited
April 16, 1962

Extract from The Financial Post, May 5, 1962

NATION'S BUSINESS

Why Do They Avoid Issues that Count?

To judge by the droves and herds of pollsters, admen, image-makers and assorted pseudo-scientific experts running the campaigns of all political parties, we are entering the final stages of the most researched and systematically organized general election in this country's history.

But it is remarkable, indeed, when the vast majority of adult Canadians have just filed tax returns that not a single politician has excoriated Canada's iniquitous and hare-brained tax structure, and that there is no significant public discussion of our vicious and punitive tax rates.

All major contenders for this country's highest offices have made national growth the central theme of their platforms — yet all ignore the fact that the tax burden in Canada is one of the heaviest in the world. This is a preposterous state of affairs in a still-maturing nation and in one of the nations where individuals making their own decisions and left with their own money to invest in their plans and in their dreams can make for the greatest national growth.

Soak-the-rich taxation is no sensible basis for running the Canadian economy. We have slow national growth because we lack a high rate of capital investment. Yet very few can save when excessive tax rates leave little incentive and who will invest when worthwhile rewards are absent?

The old-time philosophical justification for violently progressive taxation is now greatly weakened. Three decades of punitive levies have scaled down old inherited fortunes and hastened the great sell-out of Canadian companies to foreign control. Few are without cars, fewer still without TV sets and fewer still without adequate food.

It is now the high *earners* who are being soaked — precisely those Canadians who possess initiative, accomplishment and enterprise; the roots of our society. Indeed, taxation has so reached down, and inflation has so pushed up incomes that an important portion of the nation's resources of intelligence is spent devising schemes to minimize taxes, schemes that make no contribution to the productiveness of the economy.

What our tax system should do is unleash existing talent in Canada and attract new talent of all kinds. It should not punish enterprise. It should reward energy and innovation.

If Canada is to prosper as an independent nation and if we are to retain the benefits of individual initiative, then our leaders must find the political courage and the economic sophistication necessary to overhaul our whole approach to taxation and to have the courage to talk this in their campaign speeches.

Their present preoccupation with political gimmicks and giveaways will only lead to further economic slowdown and to the further weakening of that great central body of responsible Canadians which gives character to this nation.

EXHIBIT C

Merchandise Exports (Dollar Volume)

(Millions of Dollars)

	Total	To the U.K.	U.K. as % of Total	To the U.S.	U.S. as % of Total
1938	$ 848.6	$341.4	40%	$ 278.7	33%
1960	$5,405.0	$923.0	17%	$3,043.0	56%

Sources: 1938 Trade of Canada - 1938 (D.B.S.)
1960 Canadian Statistical Review, March 1962 (D.B.S.)

May 1962

EXHIBIT D

1959 Average Rates of Tax - Gross Income Classifications

Income	Less than $9,000	More than $9,000	Total
Number of taxable returns	4,076,921	165,569	4,242,490
Total income assessed	$ 14,850,205,000	$ 2,598,084,000	$ 17,448,289,000
Taxable income assessed	$ 6,895,993,000	$ 2,058,156,000	$ 8,954,149,000
Tax payable	$ 1,051,166,000	$ 528,875,000	$ 1,580,041,000
Average rate of tax (Tax payable as a percentage of taxable income assessed)	15.2%	25.7%	17.6%

Income	8,000 to 8,999	9,000 to 9,999
Taxable income assessed	$ 335,367,000	$ 249,198,000
Tax payable	$ 58,457,000	$ 44,737,000
Average rate of tax	17.4%	17.9%

Source: 1961 Taxation Statistics, Department of National Revenue

May 1962